[fol. 1] No. 8250

IN UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

TALMAGE PATRICK and COMMERCIAL BANK OF CHARLESTON, Administrators of the Estate of Attilia M. Patrick, deceased, APPELLEES

versus

UNITED STATES OF AMERICA, APPELLANT

On Appeal From The Judgment of The United States District Court For The Western District of South Carolina

APPENDIX TO THE BRIEF FOR THE APPELLANT

[fol. 2]

parties whereby Talbot Patrick purchased the stock interest of Paula M. Patrick and agreed to transfer the stock equally to the children prior to any sale of same and agreed also that upon his death the stock would automatically go to the children. The plan also provided that Talbot Patrick and Paula M. Patrick would both transfer their interest in the property at 132-138 West Main Street, Rock Hill, South Carolina, to a trust; that the trust would lease the property to the Herald Publishing Company for a term of ten years with options for renewal and the privilege of conversions. The plan aforesaid, as to the transfer of stock, was incorporated in paragraph 6 and, as to the real estate trust, in paragraph 10 of an amended stipulation and agreement between the parties which is attached hereto.

12. The firm of Boyd, Bruton & Lumpkin of Columbia, South Carolina, who at the time represented Paula M. Patrick, charged a fee of Twelve Thousand and No 100 ($12,000.00) Dollars for services in connection with the divorce action. Mr. C. W. F. Spencer, Jr., and Mr. Charles B. Ridley, both of Rock Hill, South Carolina, representing taxpayer Talbot Patrick, also charged a fee of Twelve Thousand and No 100 ($12,000.00) Dollars.

13. Talbot Patrick suggested to the stockholders that two-thirds of the legal fees, or Eight Thousand and No/100 ($8,000.00) Dollars to the attorneys for each of the two parties, Sixteen Thousand and No 100 ($16,000.00) Dollars altogether, be paid by the corporation.

14. All parties agreed thereto with the understanding that if the Internal Revenue Service did not allow the legal fees in question as a proper corporate expense, Talbot Patrick would repay the same to the corporation. This understanding was oral except in the case of Hugh Patrick who was in Ann Arbor, Michigan, and who telegraphed his understanding of the agreement. A copy of his telegram is attached hereto and made a part hereof. [fol. 7] 15. In January, 1959 Herald Publishing Company was advised by one Richard F. Murphy, Agent of the Internal Revenue Service, that the legal fees were not a proper corporate expense. Talbot Patrick, pursuant to the aforementioned understanding, repaid the sum of Sixteen Thousand and No 100 ($16,000.00) Dollars to the

issues concerning which mutual agreement could be reached. Pending completion of such negotiations, the action was held in abeyance and the Defendant's time in which to answer was extended. As a result of the negotiations aforesaid, the parties Plaintiff and Defendant entered into a Stipulation and Agreement dated April 17, 1956. Thereafter further negotiations ensued and the parties Plaintiff and Defendant have and do hereby mutually agree as follows:

1. That the within Amended Stipulation and Agreement completely supercedes and replaces in its entirety the Stipulation and Agreement dated April 17, 1956, which shall henceforth be null, void, and of no further force and effect, and shall be withdrawn from the record in this proceeding.

2. That the Defendant shall convey to the Plaintiff in fee and unencumbered the former family residence property located at 637 Oakwood Lane in Rock Hill, S. C. Simultaneously the Plaintiff shall convey to the Defendant by quit-claim deed her interest in the earlier family dwelling house at 331 Saluda Street in Rock Hill, S. C.

3. That the Plaintiff owning a one-fifth interest therein and the Defendant owning a four-fifths interest therein shall enter into a joint conveyance of the real estate in Rock Hill, S. C. at 132-6 W. Main Street, occupied by the Herald Publishing Company, and at 138 W. Main Street, occupied by Royal Crown Cola Bottling Company, the title to such real estate to be thereby transferred to the Peoples National Bank of Rock Hill, S. C., IN TRUST NEVERTHELESS to hold, manage, maintain and control the same, with full power of sale for change of investment in conjunction with any sale of the entire stock or major assets of the Herald Publishing Company at a sale price to be determined by agreement with a majority of the then adult beneficiaries of the trust, and in the meanwhile to pay the net income therefrom, after deduction of all reasonable [fol. 10] costs properly chargeable against the Lessor for repairs, upkeep, maintenance, insurance, taxes, trustees fees and other necessary costs, to Paula M. Patrick, as the same shall accrue, for and during the term of her natural life, and upon her death, to continue the trust, in

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1961

No. 22

UNITED STATES, PETITIONER

vs.

TALBOT PATRICK, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 25, 1961
CERTIORARI GRANTED OCTOBER 9, 1961

Supreme Court of the United States

OCTOBER TERM, 1961

No. 256

UNITED STATES, PETITIONER

vs.

TALBOT PATRICK, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

INDEX

[fol. 15] within written Amended Stipulation and Agreement on this the 14th day of June, 1956.

/s/ PAULA MILLER PATRICK (SEAL)
Paula Miller Patrick, *Plaintiff*

BOYD, BEUTON & LUMPKIN

By: /s/ JOHN H. LUMPKIN
John W. Lumpkin
Plaintiff's Attorneys

/s/ TALBOT PATRICK (SEAL)
Talbot Patrick, *Defendant*

/s/ CHARLES B. RIDLEY (SEAL)
Charles B. Ridley

SPENCER & SPENCER (SEAL)

By: /s/ C. W. F. SPENCER, JR.
C. W. F. Spencer, Jr.
Defendant's Attorneys

In the presence of:

(as to the Plaintiff and her counsel)

/s/ VIRGINIA R. EDWARDS
/s/ MARIE MORRIS

(As to the Defendant and his counsel)

/s/ MABEL D. BOYD
/s/ RUTH M. FAILE
/s/ MABEL D. BOYD
/s/ RUTH M. FAILE

STATE OF SOUTH CAROLINA
COUNTY OF YORK

PROBATE

BEFORE me personally appeared Virginia R. Edwards, who on oath says that she was present and saw the within named Paula Miller Patrick, Plaintiff in the above entitled action, and Boyd, Bruton and Lumpkin, by John H. Lumpkin, Plaintiff's attorneys, sign, seal, and as their act and deed deliver the within written Amended Stipulation and Agreement; and that she with Marie Morris witnessed the due execution thereof.

VIRGINIA H. EDWARDS

Sworn to and subscribed before me, this 14th day of June, 1956.

MARIE MORRIS
Notary Public for S. C.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF SOUTH CAROLINA (ROCK HILL DIVISION)

TALBOT PATRICK and COMMERCIAL BANK OF CHARLOTTE, Admr. of Estate of Alethia M. Patrick, deceased,
PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

CA/2648
May 26, 1960
Spartanburg, S. C.

BEFORE:

HONORABLE C. C. WYCHE, *United States District Judge*

TRANSCRIPT OF COURT PROCEEDINGS

APPEARANCES:

Robert M. Ward, Esq.
Attorney at Law
Rock Hill, South Carolina
For Plaintiff:

Joseph E. Hines, Esq., U. S. Attorney
Robert A. Clay, Esq., Assistant U. S. Attorney
Greenville, South Carolina

Leo Vasiliades, Esq.
U. S. Department of Justice
Washington, D. C.
For Defendant.

[fol. 17]

DIRECT EXAMINATION OF TALBOT PATRICK

By Mr. Ward:

(Tr. 10) Q. Of what, in general, did your other income consist, Mr. Patrick, aside from the salary you received from the *Herald*?

[fol. 3]

IN UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF SOUTH CAROLINA
ROCK HILL DIVISION

Civil Action 2648

TALBOT PATRICK & COMMERCIAL BANK OF CHARLOTTE,
Administrator of the Estate of Alethia M. Patrick,
Deceased

vs.

UNITED STATES OF AMERICA

DOCKET ENTRIES

1959

Oct. 10 Filing Summons & Complaint
Oct. 10 Filing Plaintiff's Demand for Jury Trial
Dec. 15 Filing Defendant's Answer with demand for jury trial

1960

Mar. 14 Case transferred to Spartanburg for trial
April 29 Case transferred to Non-Jury Calendar for trial
May 26 Trial before the Court without a Jury
June 1 Filing Deposition of C. W. F. Spencer
June 2 Filing Deposition of John H. Lumpkin
June 2 Trial continued—case taken under advisement—briefs to be presented
June 23 Filing Stipulation of Facts
June 23 Filing Defendant's Exhibit A
June 23 Filing and entering Opinion, Findings of Fact, Conclusions of Law and Order granting Judgment for plaintiff in an amount to be computed by Internal Revenue Service
June 23 Judgment entered for plaintiff in accordance with Order dated 6/22/60
Aug. 22 Filing Notice of Appeal
Sept. 20 Filing Original Transcript
Oct. 3 Filing and entering Order extending time for filing Record and docketing appeal for a period of 90 days from 9/22/60
Oct. 20 Filing Designation of Record on Appeal

A. Well, income from stocks and bonds.

Q. All right, now, on the question of the stock of Herald Publishing, you owned 28 per cent and Mrs. Patrick (Tr. 11) owned 28 per cent?

A. Yes, sir.

Q. And will you tell the Court, now, the division of the remainder of the property, of the stock of the corporation?

A. Well, at that time, our oldest son had nine per cent.

Q. Nine?

A. Nine. A trust for his benefit had seven per cent. A trust for the benefit of his younger brother had 14 per cent.

(Tr. 11) Q. What is his name?

A. His name is Wayne. Wayne Patrick and a trust for the benefit of our daughter, Paula Elizabeth, had 14 per cent.

Q. Where was the voting power in that stock which was in trust, Mr. Patrick?

A. In the trustees.

Q. And who were the trustees at that time?

A. At that time, the trustees were Mrs. Paula Patrick and myself.

Q. From whom did that trust derive, Mr. Patrick?

A. The trusts were set up by Mrs. Patrick's father.

Q. Under the terms of that trust, did anyone have the power of appointment of a trustee?

A. Yes. When he set the trusts up, individual trusts for each of his grandchildren, he was the first trustee for each trust. He had the power of appointment. In case of his death or not being able to carry on as trustee, his [fol. 18] daughter, (Tr. 12) Mrs. Paula Patrick, had the power of appointment.

Q. And Mrs. Paula Patrick was the plaintiff in this divorce action commenced against you?

A. Yes, sir.

Q. Now, Mr. Patrick, were any of your children adult at the time this divorce action was started, over 21 years of age?

(Tr. 12) A. Yes, sir.

Q. Which, if any?

A. The older son, Hugh.

[fol. 4]

IN UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF SOUTH CAROLINA

STIPULATION OF FACTS. June 23, 1960

Subject to objections to relevancy and to the introduction at the trial of any additional facts which the parties, or either of them, deem necessary, the following facts, are stipulated and agreed to by and between the parties.

1. Taxpayer Talbot Patrick is now, and during the year 1956 was a citizen and resident of Rock Hill, South Carolina; at the close of the year 1956 he was married to Alethia M. Patrick and he and the said Alethia M. Patrick filed a joint income tax return with the Director of Internal Revenue for South Carolina at Columbia. Subsequent to the year 1956 the said Alethia M. Patrick died and the plaintiff Commercial Bank of Charlotte was appointed the administrator of her estate.

2. In the said joint income tax return of Talbot and Alethia M. Patrick, an adjusted gross income was reported of Fifty-five Thousand, Five Hundred, Sixty-one and 32 100 ($55,561.32) Dollars and a tax was paid thereon of Fifteen Thousand, Twelve and 32 100 ($15,012.32) Dollars. On April 30, 1958 the taxpayers were assessed an additional income tax for the year 1956 of Nine Thousand, Nine Hundred and 69 100 ($9,900.69) Dollars, which was paid August 19, 1958, and on February 16, 1959 taxpayers were assessed an additional income tax for the year 1956 of Seven Thousand, Eight Hundred, Eighty-three and 91 100 ($7,883.91) Dollars, which was duly paid on March 4, 1959.

3. Herald Publishing Company owned and published the *Evening Herald*, the principal newspaper in Rock Hill, South Carolina.

4. Taxpayer Talbot Patrick was President and Treasurer of Herald Publishing Company and Editor and Publisher of the *Evening Herald*. In these capacities he received from Herald Publishing Company a salary of approximately Fifteen Thousand and No 100 ($15,000.00) Dollars per year.

5. In December, 1955 Paula M. Patrick brought suit against taxpayer Talbot Patrick for an absolute divorce, [fol. 5] custody of the minor children of the parties, for an equitable division of various properties and assets jointly owned by the parties, for a property settlement and adequate support.

6. Talbot Patrick retained C. W. F. Spencer, Jr. and Charles B. Ridley, both of Rock Hill, South Carolina, to represent him in connection with the action. Paula M. Patrick retained the firm of Boyd, Bruton & Lumpkin of Columbia, South Carolina, to represent her.

7. At the time of negotiations over a property settlement in the spring of 1956 the taxpayer Talbot Patrick and his then wife, Paula M. Patrick, each owned twenty-eight percent of the common stock of Herald Publishing Company. Of the remaining forty-four percent, nine percent was owned by their oldest son, Hugh T. Patrick. An additional seven percent was in a trust fund for the benefit of Hugh T. Patrick, and two other trust funds, for the benefit of their two other children, Wayne T. Patrick and Paula M. Patrick, each owned fourteen percent. The three trusts had been established for the benefit of his grandchildren by the father of Mrs. Paula M. Patrick and after his death Paula M. Patrick and Talbot Patrick jointly became successor trustees of these trusts.

8. In addition to the stock of the Herald Publishing Company, the taxpayer Talbot Patrick and the said Paula M. Patrick owned jointly various other properties, including business real estate located at 132-138 West Main Street, Rock Hill, South Carolina, which property was in part leased to and used by the Herald Publishing Company. Said Talbot Patrick owned a four-fifths undivided interest in such real estate and Paula M. Patrick a one-fifth undivided interest therein.

9. Mr. John H. Lumpkin, who represented Mrs. Paula M. Patrick spent considerable time in obtaining information pertaining to the value of the interests of each party, including the stock of the publishing company and was approached by third parties and discussed on several occa- [fol. 6] sions the sale of a controlling stock interest in Herald Publishing Company to prospective purchasers.

10. A plan was worked out by the attorneys for the

porate officer and of the active executive responsibility for the newspaper's production.

Q. We have spoken of the stock. Was there any other property owned by you which figured in this property settlement with Mrs. Patrick? Was there any business property?

(Tr. 14) A. Yes, there was business real estate with two buildings on it; one occupied by the newspaper and one by Royal Crown Cola Bottling Company. The two buildings are just side by side with a driveway between them.

Q. And how was that property owned, Mr. Patrick?

A. It was owned one-fifth by Mrs. Patrick and four-fifths by me.

Q. With respect to the divorce action itself, did you have any defense to the action as filed by Mrs. Patrick?

Mr. Vasiliades: I object to that.

The Court: That's a pretty broad field, whether he had a defense. It depend altogether on what the grounds were. I think that you would have to prove what the grounds of the divorce were before he could testify whether or not he had any defense to it, whether or not he admitted it. Just saying did he have a defense to it, that doesn't mean a thing to me.

[fol. 20] Q. All right, sir, Mr. Patrick, what was the ground on which Mrs. Paula Patrick demanded divorce?

A. Adultery.

Q. Did you file or did your lawyers in your behalf file any Answer for you?

A. They filed a formal Answer, yes.

Q. Did you appear and defend . . .

The Court: You can ask him whether or not he denied the allegations of the Complaint.

Q. Did you deny the allegations of the Complaint, Mr. Patrick?

A. Yes, sir, to my recollection I did.

Q. Did you appear and defend on the question of adultery in the divorce action?

A. My attorneys were at the hearing. I was not.

Q. You were not at the hearing?

A. No, sir.

Q. Mr. Patrick, did you have attorneys employed in this divorce and property settlement matter?

A. Yes, sir.

Q. Who were your attorneys?

A. Spencer & Spencer and Charles Ridley.

Q. Both of . . .

A. Rock Hill.

Q. Who represented . . .

The Court: Spencer & Spencer and who else?

Mr. Ward: Charles B. Ridley.

Q. Who represented Mrs. Patrick in this matter?

A. The firm of Boyd, Bruton & Lumpkin, of Columbia.

Q. Over what period of time did this suit continue, Mr. Patrick, approximately?

A. Oh, golly . . .

Q. I believe you say it was commenced in '55 . . .

A. . . . I would say something like eight or nine months. (Tr. 16) I guess.

Q. Approximately when was it concluded?

[fol. 21] A. Middle of 1956, June.

Q. Mr. Patrick, do you know whether all of the time involved in this action related to the divorce itself or the property settlement or do you know whether the work was divided between those times?

A. Well, of course, the work was divided. Most of the time that the lawyers took up with me and in conference with each other was,— because I talked with my lawyers and they talked with the others, was trying to work out something on this newspaper control.

The Court: For my information, are attorney's fees spent in defending a divorce action are those deductible or not?

Mr. Vasiliades: No, sir, they are not.

The Court: Do you agree to that?

Mr. Ward: So far as the divorce itself is concerned, yes, sir.

The Court: Go ahead.

Q. Mr. Patrick, in general terms, how was the property settlement consolidated between yourself and Mrs. Patrick? What was the result of the settlement?

A. Well, the result as concerned Herald Publishing Company was that I bought, subject to limitation, her stock

Herald Publishing Company; the corporation was thereupon assessed and paid an additional tax of Eight Thousand, Three Hundred, Twenty and No/100 ($8,320.00) Dollars thereon. The said repayments to Herald Publishing Company were made $10,000.00 on March 4, 1959 and $6,000.00 on July 20, 1959.

16. The taxpayer's legal fees paid by the corporation have been treated by the Internal Revenue Service as a dividend to Talbot Patrick and his income has been increased accordingly.

17. This alleged increase of Sixteen Thousand and No/100 ($16,000.00) Dollars in Talbot Patrick's gross income decreased his medical expense deduction by three percent thereof, as Four Hundred, Eighty and No/100 ($480.00) Dollars.

18. Of the Twelve Thousand and No/100 ($12,000.00) Dollars fees paid to the attorneys for each of the parties, Two Thousand and No/100 ($2,000.00) Dollars of each was allocated by the taxpayers and/or their counsel to the establishment of the trust, the transfer of it of the real estate of Talbot Patrick and Paula M. Patrick located at 132-138 West Main Street, Rock Hill, South Carolina, and the leasing of said property to Herald Publishing Company.

19. The entire net income from the trust property was to be paid to Paula M. Patrick for her lifetime and at her death if the children are all adults, the property was to be distributed to them. A copy of this trust indenture is attached hereto and made a part hereof.

20. On or about May 1, 1959, Plaintiffs mailed to the Director of Internal Revenue a claim for refund for the sum of Twenty-One Thousand, Six Hundred, Seventy-three and 73/100 ($21,673.73) Dollars. This claim was [fol. 8] based on a recomputation of the plaintiffs' tax upon theories: claiming the legal expenses of Three Thousand, Two Hundred and No/100 ($3,200.00) Dollars (allegedly in connection with the property at 132-138 West Main Street, Rock Hill, South Carolina), claiming the legal expense of Sixteen Thousand and No/100 ($16,000.00) Dollars (allegedly in connection with settling stock ownership of Herald Publishing Company and treating the payment of this portion of the legal fees by Herald

in Herald (Tr. 17). Publishing Company, the condition being that that stock in case of my death would go to our children or in case there should be a sale of the newspaper, or the stock of the newspaper, that that stock should go to the children prior to such sale.

The Court: For my information also, so that I can follow this, I would like to know was this divorce proceeding determined by Order of the Court or by agreement as to this property settlement?

Mr. Ward: May I answer that?

The Court: Yes.

Mr. Ward: It was determined by final Order of the Court by Judge Baker of the Circuit Court.

[fol. 22] *The Court*: Was that Order based upon testimony in the trial or based upon agreement of the parties?

Mr. Ward: Based upon testimony in the trial.

The Court: In the trial?

Mr. Ward: Yes, sir. Your Honor knows that the moving party has to come forward and make out a case of divorce.

The Court: Oh, yes.

Mr. Ward: And that was done and . . .

The Court: The South Carolina Statute requires that.

Mr. Ward: Sir?

(Tr. 18) *The Court*: The South Carolina Statute requires that.

Mr. Ward: Yes, sir. There is no such thing as a default divorce. The plaintiff has to come make out a case even if the defendant doesn't answer. But the plaintiff in the record came in and made out a case for nullity based upon the proof of circumstances and admissions and . . .

The Court: Who fixed the amount of settlement, the judge or by separate agreement?

Mr. Ward: No, sir, the property settlement, the entire property settlement was worked out between the attorneys and the parties and incorporated in the divorce decree.

The Court: By consent?

Mr. Ward: Yes, sir.

The Court: All right.

Mr. Ward: The property settlement left upon [illegible]

Publishing Company as a loan and not a dividend). Said claim is attached hereto and made a part hereof.

21. On August 21, 1959, the aforementioned claim was rejected in full and this suit was brought in September, 1959.

Attorneys for Plaintiff

Attorneys for Defendant

ATTACHMENT TO STIPULATION OF FACT

STATE OF SOUTH CAROLINA
COUNTY OF YORK

PAULA MILLER PATRICK, PLAINTIFF

vs.

TALBOT PATRICK, DEFENDANT

IN THE COURT OF COMMON PLEAS
AMENDED STIPULATION AND AGREEMENT

The above entitled action was brought by the Plaintiff against the Defendant for an absolute divorce, for custody of the children of the marriage, for retention of her marital name, for supervision by the Court of the equitable division of various properties and assets jointly owned by the parties, for appropriate provision by way of property settlement for Plaintiff's needs, for payment of Plaintiff's attorneys fees by the Defendant and for such other relief as the Court might deem just and equitable.

[fol. 9] Following the commencement of the action negotiations were undertaken by the parties, through their respective counsel, looking towards the elimination of all

termination of the Court, as it had to do under the law, the question of divorce, but it settled all other matters between the parties.

The Court: All right.

Q. Mr. Patrick, the agreement as to the disposition of property is set forth, in this amended stipulation and agreement attached to the — to our stipulation, is it not?

A. Yes, Sir.

Q. And also a trust which was set up at that time?

(Tr. 19) A. Yes.

(Vol. 23) Q. How much were the attorneys' fees in this matter?

A. $24,000.

Q. And that was how much for each side of the case?

A. Twelve Thousand for each side.

(Tr. 23)

Q. After the payment of this $16,000 in attorneys' fees by the corporation had been disallowed, did you or not repay that amount to the corporation?

A. Yes, sir, I did.

(Tr. 24)

Cross-Examination:

By Mr. Casiliades: Mr. Patrick, prior to the settlement with your former wife, Mrs. Paula Patrick, did you at any time own a majority of the stock of the paper?

A. No, sir.

Q. Actually, these settlement negotiations you speak of, through those you hoped to gain control of the paper rather than maintain control of the paper?

A. Well . . .

The Court: Is that correct or not?

The Witness: I had a control . . .

(Tr. 25) *The Court:* No, that doesn't answer it. Counsel is entitled to an answer to his question. He asked you a simple question. He asked if that is correct or not. If it

the same manner until the youngest child of the parties shall reach the age of twenty one years, paying the net income therefrom in equal shares to the children of the parties, Hugh Talbot Patrick, Wayne Tyler Patrick and Paula Elizabeth Patrick, and when such youngest child shall have reached the age of twenty one years, to thereupon terminate the trust and convey the real estate and distribute any remaining income, in equal shares, to the three children aforesaid, subject to the terms of the trust, provided, however, that prior to the establishment of such trust the Plaintiff and Defendant shall first so modify the present lease agreement with the Herald Publishing Company as to provide for the leasing of the entire property, including the property heretofore occupied by the Royal Crown Cola Bottling Company, at a total annual rental for the entire property of $15,000.00 per annum, such modified lease to terminate on June 30, 1965, and same to contain a provision granting to the Lessee the right, privilege and option to accomplish improvement of the entire property, including the Royal Crown Cola Bottling Company property upon the following conditions:

(a) The lessor shall tender to the owner or trustee a firm agreement to pay adequate increased rental to amortize the cost of the improvements within the remaining term of the lease, or within such increased term, of not exceeding ten years, as will permit liquidation of the cost of the improvements on a ten per cent annual principal reduction basis; and in such case the lease shall stand extended for such additional term, with all provisions thereof, except as to the increased rental, cost being as before.

(b) The trustee or the owner shall thereupon mortgage the leased premises to provide the necessary funds for such improvements.

(c) The additional rent tendered by the lessee shall [fol. 11] be adequate to reasonably assure that the mortgage can be liquidated out of such increased rent only without necessity for charging any part of the costs of any such improvements, or of the cost of or interest upon funds borrowed therefor, against the $15,000.00 per annum rental being paid prior to the making of such im-

provements. This requirement shall not deprive the mortgagee of a valid first lien mortgage after the owner or trustee shall have determined adequate compliance therewith and given a first lien mortgage pursuant hereto.

(d) As an alternative to making improvements under subparagraphs (a), (b), and (c) above, the lessee may at its option make such improvements entirely at its own expense, upon first making independent arrangements with the owner or trustee satisfactory to adequately assure the owner or trustee of payment of the entire cost of such improvements by the lessee, and in such case no additional rent shall be paid by the Lessee for the use of the improvements made at the sole expense of the lessee.

(e) Unless it is determined that increased rental tendered by the Lessee, if any, is adequate to cover not only any deb. liquidation costs, but in addition thereto any maintenance costs relative to the improvements, which would otherwise fall upon the trustee or owner, the lessee shall bear the full cost of maintenance of the improvements.

(f) All improvements made by the Lessee under the terms hereof shall be and become the property of the owner or trustee and be surrendered with the desired premises at the termination of the Lease.

(g) The foregoing terms and conditions for the making of any such improvements may be modified at any time by mutual agreement between the Herald Publishing Company, Talbot Patrick and the then adult beneficiaries of the trust.

4. That the Defendant shall pay to the Peoples National Bank of Rock Hill, S. C., for the account of the Plaintiff, quarter annually in advance, cash funds at the rate of $2,500.00 per annum for the sole purpose of defraying the educational costs and expenses only of Paula [fol. 12] Elizabeth Patrick, the daughter of the parties, such payments to continue until the said Paula Elizabeth Patrick reaches 21 years of age. All expenses for general support and maintenance of the said Paula Elizabeth Patrick, after excluding educational costs and expenses, shall be borne by the Plaintiff, with whom she resides.

The Plaintiff shall have the right, in view of the foregoing, to claim the said Paula Elizabeth Patrick as a dependent for tax purposes, and no such claim shall be asserted by the defendant.

5. That the Defendant shall continue as at present to pay directly to Wayne Tyler Patrick, the son of the parties, during his minority, such sums as shall be reasonably necessary to his proper maintenance, upkeep, support and education.

6. That the Plaintiff shall transfer to the Defendant her entire stock interest in the Herald Publishing Company and in exchange therefor the Defendant shall transfer to the Plaintiff high quality listed stocks and municipal bonds, approved by the Plaintiff, of a value equal to the value of the Herald Publishing Company stock belonging to the Plaintiff, with cash adjustment between the parties of any minor differential in value. The actual value of the stock interest in the Herald Publishing Company held by the Plaintiff has been fixed by actual agreement of the parties evidenced by separate agreement of even date herewith. Should any question arise concerning the value of the stocks and bonds to be transferred by the Defendant to the Plaintiff, the Defendant shall eliminate the items in question and substitute other acceptable items or pay in cash the amount under question. The Herald Publishing Company stock shall be transferred to the Defendant, upon the condition and limitation hereby imposed, that said Defendant shall not mortgage, pledge, encumber, assign or sell said stock at any time, except that same may be sold along with and as an incident to the sale of all other stock in the Herald Publishing Company. On any such sale the stock shall be first transferred by the Defendant to Hugh Talbot Patrick, Wayne Tyler Patrick and Paula Elizabeth Patrick in equal shares [fol. 13] between them, and they shall in turn make the sale and receive the proceeds thereof in their own right. Should any one of them be under any disability the share of such child shall be transferred to a trustee for the benefit of such child and the trustees shall forthwith make such sale and receive the proceeds thereof. Should no such sale occur, the stock shall automatically pass, by virtue of this agreement, to the three children above.

named upon the death of the Defendant. At his election the Defendant may, prior to his death, commence the gradual transfer of said stock in equal shares to his children, the ultimate beneficiaries thereof upon his death. The limitations hereby imposed upon the transfer of said stock by the Defendant shall not affect in any manner his right to the income from and control of said stock and particularly the full right and privilege to vote the same in such manner as he, in his sole discretion, shall deem fit and proper.

7. That in the event of any default in payment thereof the Defendant agrees to purchase from the Plaintiff, at the then remaining face value thereof, the shares now owned by the Plaintiff in the debentures of Wayne Printing Company in Goldsboro, N. C.

8. That the Defendant hereby consents and agrees that the custody of Wayne Tyler Patrick and of Paula Elizabeth Patrick, during their minority, shall be awarded to the Plaintiff, subject to reasonable visitation right at any and all reasonable times in favor of the Defendant

9. That all rights of inheritance as between the parties Plaintiff and Defendant and any right of dower in favor of the Plaintiff shall henceforth be at an end and of no further legal force and effect.

10. That the parties Plaintiff and Defendant shall henceforth live separate and apart, and that each of said parties specifically declares that their present differences are beyond reconciliation.

11. That the Defendant shall pay to the Plaintiff or to Plaintiff's attorneys, an account of the services of such attorneys to the Plaintiff in the above entitled proceeding [fol. 14] and in negotiating this agreement, such sum as shall be hereafter fixed by agreement of the parties or order of the Court in this proceeding.

12. That the Defendant shall pay all costs of this action as termed by the Court.

13. That by virtue of this agreement all issues in the above entitled action are resolved and settled accepting only the sole remaining issue of whether or not the Plaintiff is entitled to an absolute divorce against the Defendant as sought in this action and this issue is specifically reserved for determination by the Court.

14. That such of the parties agrees that the terms and conditions of the within written Amended Stipulation and Agreement shall operate and be binding as a civil contract between the parties and shall in addition thereto, by consent of the parties hereto, be incorporated in and made a binding part and portion of such final decree of the Court as is hereafter issued in the above entitled action.

15. That by virtue of this agreement a final and lump settlement has been made of any and all rights whatsoever by and between the Plaintiff and the Defendant concerning the matter of support, separate maintenance, alimony or any financial obligation of whatsoever sort due to the Plaintiff by the Defendant on account of and growing out of the marital relationship of the parties; as that henceforth any and all such rights shall be at an end, except as may be otherwise required by the terms of this agreement.

16. That this agreement is and shall be binding upon the parties hereto and their respective heirs, executors, administrators, and assigns, forever.

IN WITNESS WHEREOF, the parties and their counsel of record have hereunto set their hands and seals to the

A. As I said, I didn't pay. There were two payments to them: one was a payment from Herald Publishing Company; the other was a payment from the account of this business real estate which Mrs. Patrick and I owned, she owning one-fifth and I owning four-fifths.

Q. I agree with you, Mr. Patrick, that you didn't pay but you are seeking to take as a deduction, are you not, the amount which the Herald Publishing Company paid your wife's attorneys for representing your wife in the settlement negotiations?

(Tr. 36) A. I am trying to take into account the money Prepaid to Herald Publishing Company after the Internal Revenue people refused to allow that as a deduction to Herald Publishing Company.

Q. Part of that money was paid to your wife's attorneys for representing her in the settlement negotiations?

A. By Herald Publishing Company.

Q. That's the same amount you are trying to take as a deduction personally? Is that true?

A. Yes.

. . . . .

[fol. 30] (Tr. 38) *Mr. Posilbides:* I should like to ask another question, your Honor. (Addressing the witness) Mr. Patrick, during the course of these settlement negotiations, or prior, (Tr. 39) did Mrs. Patrick ever seek an injunction prohibiting you from disposing of your stock or encumbering it in any way?

A. No. You mean what I already owned?

Q. Yes.

A. No.

Q. Did she at any time question your right or title to the shares in your name?

A. No.

. . . . .

Caption Omitted

Deposition of C. W. F. Spencer, Jr.

Appearances:

Robert M. Ward, Attorney
Rock Hill, S. C.

For Plaintiffs

Mr. L. W. Vaughan
Justice Department
Washington, D. C.

For Defendant

(p. 1)

Direct examination by Mr. Ward

Q. Mr. Spencer, will you state your name for the record?

A. C. W. F. Spencer, Jr.

Q. You are a lawyer practicing in the City of Rock Hill, in the State of South Carolina?

A. I am.

(p. 2)

Q. In or about 1955 to 1956 were you not employed by Mr. Talbot Patrick in connection with a suit brought against him by his wife, Mrs. Paula M. Patrick?

[fol. 31] A. I was through association with Mr. Charles B. Ridley, another Attorney practicing in this City.

Q. Have you or not been requested by Mr. Talbot Patrick to testify in this matter and has he released you from the confidential relationship imposed by your capacity as counsel for Mr. Patrick in the aforementioned suit in order to enable you to testify in this proceeding without limitation by such relationship?

A. Mr. Patrick has made a request to me and has indicated his desire and willingness for me to testify at the present time without limitation on account of the matters and things aforesaid. It has also been agreed that this request and release is to be confirmed in writing as of this

date, and that the written confirmation shall be attached to and made a part of this deposition.

Q. Mr. Spencer, what was the nature of the action originally brough by Mrs. Patrick against Talbot Patrick?

A. She sought divorce on grounds of adultery, and asked for Court supervision of division of properties and for an appropriate property settlement in her favor, together with custody of the children of the marriage, and an allowance of counsel fees in her favor.

Q. Did Mr. Patrick actually defend the divorce which was brought on the grounds of adultery?

A. Mr. Patrick filed an Answer in which he neither admitted or denied the allegations of paragraphs 3 and 4 of the Complaint setting up the alleged grounds for divorce. This Answer was (p. 3) filed after a considerable extension of time in which to plead during which a complex Stipulation had been worked out and agreed upon with reference to the matters of division of jointly owned properties and various other property questions together with questions involving custody of children. Mr. Patrick did not oppose the request of his wife for custody and agreed to her dicress to be custodian. The record will disclose that he offered no testimony in opposition to the Plaintiff's demand for divorce.

(fol. 32) Q. In the pleadings did Mr. Patrick make a specific or general denial of the allegation of adultery?

A. The allegation of adultery is contained in paragraphs 3 and 4 of the Complaint and as I have already testified, he neither admitted or denied this allegation. He did demand strict proof thereof, but he did not offer any testimony either personally or on his own behalf controverting the testimony of the Plaintiff, which latter testimony included Plaintiff's statement that the Defendant Talbot Patrick had in fact admitted to the Plaintiff his guilt of the charge of adultery. He was not present at the taking of this testimony before the Court, but he was represented by counsel in the persons of myself and Mr. Ridley at the hearing.

Q. Mr. Spencer, was any property of Mr. Patrick's involved in this action for divorce which asked for a property settlement?

A. The matter of property settlement was the major or chief factor involved in the proceeding. As indicated by what I have already said, there was no real contest between the parties on the basic issue of divorce. The Defendant denied the allegations and demanded strict proof thereof, as to have done otherwise might have been indicative of collusion, but the question of divorce or no divorce was never a real issue of any consequence. The amounts involved in the property settlement (p. 4) negotiations were definitely substantial and the factor of control of certain of these assets involved was of major significance.

Q. Mr. Spencer, to your knowledge was any of the property of Mr. Patrick involved in this action not income producing property, in other words, was there some property involved which was not income producing property?

A. According to my recollection, no property of a non-income producing nature was involved so far as I know. I would qualify that answer to this extent: that I refer to property normally considered to be income producing rather than to specific knowledge that it was income producing at the moment of the negotiations. I have in mind (fol. 321) particularly the residence property where Mrs. Patrick resided and a vacant house on Saluda Street which, as I recall it, was boarded up and not occupied by a tenant. There was never any real issue involved over these properties as I recall it. The properties chiefly involved had to do with stock in the Herald Publishing Company and joint ownership by Mr. and Mrs. Patrick of the Rock Hill real estate which the Herald Publishing Company occupies under lease, for its business operating quarters.

Q. Do you consider, Mr. Spencer, that this action posed any threat to Mr. Patrick's retention of income producing property and to the preservation of his income?

A. Definitely yes. Mr. Patrick at that time held 28 percent of the outstanding stock in the Herald Publishing Company. His wife held in her own name an equal number of shares. A few shares were held by Hugh Patrick. The remaining shares were held by Mr. and Mrs. Patrick jointly as Trustees for their children. (p. 5) As joint owner of the Trustee stock, Mrs. Patrick was in a position

Q. And he was the one who owned the 9 per cent stock you testified to?

A. Yes, sir.

Q. Mr. Patrick, did Hugh Patrick, your son, who owned the 9 per cent of the stock, support you and cooperate with you at the time this property settlement was asked by Mrs. Patrick?

Mr. Vasiliades: Your Honor, I would have to object to that question. It calls for a conclusion of the son's mental operations; and we have no objection if Mr. Ward would like to ask him specifically what the son did on certain occasions but when he uses a general term like "support," I don't think that calls for a statement of fact.

The Court: Well, it's a non-jury case. I will let him answer and you can cross-examine about what he did, the details of it. Go head. From his opening statement, he claims, as I understand, that that was one phase that you had to work (Tr. 13) out in settlement of your divorce proceedings? Go ahead.

The Witness: Yes, sir.

Q. The question, Mr. Patrick, was did Hugh Patrick support you and cooperate with you in this property dispute?

A. I would say that he, rather — he supported his mother rather than me, but when we were finally toward the end of the case, trying to reach an agreement, he did agree to [fol. 19] what had been worked out by her attorneys and mine, that Herald Publishing Company should pay a part of the fees but with the limitation that I should agree that if this payment was disallowed, I would repay it to the company.

Q. Could you, Mr. Patrick, vote the stock of Hugh Patrick in any stockholders' dispute in '55?

A. Oh, no, sir.

Q. What direct effect, if any, did this suit have on your situation as president of Herald Publishing Company, and as editor and publisher of the *Herald*?

A. Well, it threatened to put a complete end to it because while there had been unity in the family, there was no question about it, I was now in the position where I might very well be moved out of my position as a cor-

an amended lease of the business property operated by the corporation so as to preserve and protect its ability to maintain continued occupancy of its business quarters.

Q. In the course of the proceedings so far in the Federal District Court we discussed a figure of $3200,00, which Mr. Patrick states was with respect to the business property. Do you have any knowledge as to a division of the ownership of title to the business property?
(p. 8)

A. The business property was owned one-fifth by Paula M. Patrick, and four-fifths by Talbot Patrick, and of course as a tenant in common Mrs. Patrick had equal right with Mr. Patrick to control or block control of the use of the business real estate. This factor made it important to the corporation to have some arrangement worked out by way of lease. From the standpoint of the property owners themselves, it was also important that some stable [fol. 25] arrangement be worked out so as to preserve continued income producing capability of the real estate.

Q. This allocation I have questioned you about, was that simply an allocation made by the attorneys or was that done with the parties and between the attorneys and the parties?

A. Yes, it was worked out by mutual agreement between counsel on both sides and the parties on both sides. You recognize that, as Mrs. Patrick had asked the Court for an allowance of counsel fees and was seeking to have all fees that were involved placed on other than herself, the question of fees was a part (p. 9) of the matters that had to be negotiated and worked out by agreement between counsel and the parties, and in so doing I back at the time when the matter was fresh and I was in a far better position to have judged and evaluated them as differentiated from now, some 5 years later, the allocation that was worked out was considered to be fair and proper and in an appropriate relation one to the work load involved and the division of that work load as between the different phases of the matter which had required handling on the part of counsel on both sides.

(p. 10)

Cross Examination by Mr. Vasilakis.

Q. Mr. Spencer, these difficulties between Mr. and Mrs. Patrick which necessitated Mr. Patrick hiring you as his attorney all resulted from family difficulties. Is that true?

A. The fact of separation and impending divorce resulted from Mrs. Patrick's charge that Mr. Patrick was guilty of adultery. I would assume that that would come within the phrase which you have used of family trouble or difficulty. The property settlement matters I would say came about because of the fact of impending divorce, but it was not the family troubles which caused the property settlement problem, but simply the necessity in the light [fol. 36] of the fact that divorce was imminent to do something about these matters, much as would be true if you had a business partnership and one of the members was withdrawing, they might withdraw because of personal differences between one and the other, but the fact of withdrawal created a business rather than a family necessity to do something about the property rights involved, which in this case had been theretofore jointly held and controlled and which by virtue of the impending divorce it became necessary to work out some arrangement for future separate ownership on such basis as would cause maximum protection and minimum financial loss to the parties on both sides growing out of change of ownership being effected.

(p. 11)

Q. Did Mr. Patrick, or attorneys acting on her behalf, at any time seek an injunction prohibiting the alienation, encumbering or secreting of any of Mr. Patrick's real or personal property?

A. According to my recollection, there was no such action taken. The parties through their counsel were engaged in negotiations looking towards disposition of all property questions by amicable means. Although the negotiations were long and difficult they were nevertheless continuous and no situation ever arose indicating any immediate threat of disposition of assets which would have had a bearing upon the matter. I would say this, that the

negotiations were of such nature and character as to indicate definite and positive interest and demand on the part of Mrs. Patrick that certain of the assets belonging to Mr. Patrick should be in such a way set aside or earmarked as to assure that they would eventually pass out of the hands of Mr. Patrick and into the hands of the children.

Q. Your answer was "no" to the question? My question is, was an injunction sought by Mrs. Patrick to accomplish those items which I had previously mentioned, namely, to prohibit the alienation, encumbering or secreting of any of Mr. Patrick's real or personal property?

[fol. 37] A. As I have previously stated, I have no recollection of any such injunction being obtained.

Q. Did Mr. Patrick at any time question Mr. Patrick's rights or title to the shares of Herald-Publishing Company stock in his individual name?

A. Do I understand you to ask whether she asserted some claim to ownership of the 28 percent in his name?

Q. That is the question.

A. I do not recall any such claim or assertion.

(p. 12)

Q. On direct examination I believe you stated — correct me if I am wrong — that Mrs. Patrick never made any threat to the continued operational control of the Herald by Mr. Patrick, however, you felt you would have been derelict in your duty as counsel had you failed to take into account the extreme danger to your client which remained outstanding so long as he was subject to being outvoted?

A. To the best of my knowledge, that is a correct statement of the answer I gave.

Q. Was a considerable amount of the settlement negotiations attributable to an effort on the part of Mr. Patrick to acquire Mrs. Patrick's interest in the Herald Publishing Company?

A. I would say that that would be a correct statement, and that the acquisition of her stock or the ability to control it had a direct bearing on his continued ability to control operations of the Herald Publishing Company, of which he was editor and publisher.

is correct, you say, "Yes, sir"; if it is not correct, you say "No."

Q. Through the settlement negotiations centering about this divorce, you hoped you would gain control of the paper rather than maintain control?

A. Prior to that period, I had maintained control by family agreement.

The Court: Counsel is entitled to an answer to his [fol. 24] question, Mr. Witness. Is that true or not? If it is not true, say, "No"; if it is true, say, "Yes."

The Witness: Oh, No.

The Court: That answers it.

Q. What percent of the stock, once again, of the newspaper did you own prior to the settlement?

A. Prior to the settlement, I owned personally 28 per cent.

Q. It is your testimony that by owning 28 per cent of this stock, you controlled the corporation?

A. No, that is not my testimony, sir. I said that so long as there was unity in the family, I operated in control of the paper. I was the manager. I was the president.

Q. This was during the pleasure of the other stockholders; it wasn't by virtue of your controlling interest? (Tr 26) A. That is right.

Q. Your former wife, Mrs. Paula Patrick, what was the extent of her newspaper experience?

A. The experience of being the wife of the editor and publisher for a good many years and participating in the affairs of the company as a corporate officer, of being present at meetings of newspaper people.

Q. Let me ask you this question: you being a newspaper man of long standing, would your wife have been able or capable to efficiently manage this newspaper on her own?

A. In my judgment, no.

Q. Did she desire to do so?

A. I don't know.

Q. You don't know.

A. I don't know.

Q. That didn't come up during this settlement negotiations?

A. No, sir.

Q. What demands did Mrs. Patrick make upon you during these settlement negotiations?

A. Well, she wanted a property settlement to maintain [fol. 25] the standard of living she had enjoyed while we were living together; she wished control of the minor children after the divorce; and judging by the length of time it took to reach an agreement on the stock of the newspaper company, she wished to retain that stock herself.

(Tr. 27) Q. Do you know that to be a fact?

A. I could judge it only by the length of time it took to try to work out some agreement which would result in the corporation staying in a manageable situation.

Q. Let's go into this agreement concerning the stock a little more specifically now. This is my understanding of it. You tell me if I am right: your wife transferred to you her shares during the period of your life, at which time the shares were to revert to your three children? Is that correct?

A. That is correct, as far as it goes.

Q. Well, amplify it if you will.

A. Also in case there should be a sale of either the stock in the paper or of the property developing, that stock from her should prior to such sale be turned over to the children.

Q. In your opinion, was this stock transferred at fair market value?

A. It was a value established on offers for the paper made at that time. I would say that was a fair market value.

Q. Then you, in effect, paid fair market value for stocks and you only got a life estate in that stock? Is that correct?

A. That's right.

Q. Did you readily agree to that or did that take a little negotiating?

A. I beg your pardon?

(Tr. 28) Q. Didn't that take a little negotiating or did you readily agree to that?

A. Well, it — I agreed fairly quickly. Much more quickly than she agreed to the sale.

[fol. 26] Q. In other words, you had no objections to paying fair market value for a purchase of stock when you only received a life estate?

A. Well, after all, upon my death it went to my children, which was satisfactory to me.

Q. What was your income from the newspaper in 1956?

A. I'd have to look at the tax return, I guess, to see because there was salary and also dividends.

Mr. Vasiliades: May I have this marked defense exhibit for identification?

(Tax return marked for identification as Defendant's Exhibit A)

Q. I hand you Defense Exhibit "A" for identification and ask you if you can identify that?

A. Yes, that is the income tax return for 1956.

Q. Is that your signature that appears at the bottom of Page 1 there?

A. Yes.

Q. The other signature is that of your second wife?

A. Yes, now dead.

Q. Can you look at that return first of all, for me (Tr. 29) offer this into evidence as Defense Exhibit "A":

(Defendant's Exhibit A for identification received in evidence as Defendant's Exhibit A.)

Q. Would you look at that return and tell me, first of all, what your salary was as an officer of this newspaper corporation?

A. Looking at the figures, I can't answer that because the figure combines a rather small salary as an officer of the corporation with a larger salary as the main executive of the newspaper publication.

Q. Give us the combined

A. The combined was $15,027.

Q. $15,027?

A. Yes, sir.

[fol. 27] Q. What was your total income reported during the year 1956?

A. Adjusted gross income, $55,561.

Q. So this . . .

A. Of which . . .

Q. I think you have answered.

A. . . . $5400 came from Herald Publishing Company as dividends.

Q. $5400?

A. Yes.

Tr. 30) Q. Add that to your other receipts from the newspaper and what do you have?

A. $29,427.

Q. In any event, the total is less than half of your income for that year? Is that correct?

A. That's right.

Q. Even if you had lost your entire stock and interest in the newspaper, you would still have a considerable income? Is that correct?

A. Well, much less than that return would indicate because I also made a property settlement on Mrs. Patrick in connection with the divorce from which, of course, thereafter I would receive no income.

Q. I believe Mr. Ward asked you this question: you denied the allegations made by your wife in the divorce proceedings? Is that correct?

A. That was in the Reply to the proceedings, yes.

Q. This matter of the $16,000 paid by the corporation on your behalf, when did you repay that? I say, when did you repay it?

Mr. Ward: It's in the stipulation, may it please your Honor.

(Tr. 33) Q. You testified that you had to pay your wife's attorneys also? Is that right?

A. Yes, sir.

Q. And that amount is exactly one-half of the attorney's fees in the entire litigation?

[fol. 28] A. That's — both — the attorneys on both sides had the same size fees.

Q. Twelve Thousand apiece?

A. Yes, sir.

Q. And you paid the entire Twenty-four Thousand?

A. The Court so ordered.

Q. Now, these attorneys representing your wife, that was the firm of Boyd, Brayon & Lumpkin?

(Tr. 34) *The Court:* Let me ask a question: was that fee fixed by the judge in the decree?

Mr. Ward: No, sir.

The Court: What fee, if any, was fixed by the judge in his decree?

The Witness: I thought it was.

Mr. Ward: The divorce decree didn't fix a fee.

The Court: Didn't fix any at all?

Mr. Ward: No, sir.

The Witness: That's my error. I thought it was.

Q. These attorneys that represent your wife, they weren't, of course, also working for you at the same time, were they?

A. They were not working for me.

(Tr. 34). Q. And they weren't interested in your getting control of this newspaper, were they?

A. No, sir, I would say not.

Q. Yet, you claimed as a deduction that portion of the attorneys' fees which you paid on behalf of your wife, did you not?

A. No, what was — what I paid for her against the divorce, I did not claim as a deduction.

Q. You claimed as a deduction part of your wife's legal fees, did you not?

The Court: For the divorce.

The Witness: For the divorce? No, sir.

(Tr. 35) Q. For the settlement negotiations in connection with the divorce?

[fol. 29] A. No, sir, I didn't pay that. The — there were two payments on the settlements: one from the account of this jointly held business real estate, of which one-fifth of the payment was from her account and four-fifths from my account; the other, from Herald Publishing Company.

The Court: How much do you claim you paid your wife's attorneys?

The Witness: I paid —

The Court: One minute. As fees for their representing her in the divorce proceedings?

The Witness: Two Thousand Dollars.

The Court: All right.

(Tr. 35) Q. How much did your pay your wife's attorneys as their fees for representing your wife in the settlement negotiations?

to effectively deprive Mr. Patrick of control of the Truster stock. The combined stock held by Mrs. Patrick individually, plus that held by her son Hugh Patrick exceeded the amount of stock held by Mr. Patrick and thereby placed him in the position of being a minority stockholder. In connection with any domestic relationship matter where divorce becomes involved, the future relationship between the parties to the union necessarily becomes a matter of considerable uncertainty. This factor was definitely present and was considerably involved in the negotiations. I do not mean by this statement to assert that Mrs. Patrick ever made any positive threat against continued operational control of the Herald Publishing Company by Mr. Patrick. However, I would have felt considerably derelict in my duty as counsel had I failed to take into account the extreme danger to my client which remained outstanding so long as he was subject to being outvoted by an estranged and in process of becoming divorced wife and one of his children.

[fol. 34] (p. 7)

Q. Mr. Spencer, what were the total attorney's fees involved in this whole matter of Patrick v. Patrick?

A. Total counsel fees involved came to $24,000.00, of which one-half went to Plaintiff's attorneys and one-half went to Defendant's attorneys.

Q. Was there any allocation of those fees as to application to the divorce itself as distinguished from the matter of property settlement.

A. Yes, there was.

(p. 8)

Q. What was the nature of that allocation?

A. $4,000 of the total compensation was treated as being the amount applicable to the divorce proceeding. $4,000 was treated as applicable to income from jointly owned business real estate and $16,000 was treated as applicable to rearranging the stock ownership and control of the Herald Publishing Company in such manner as to preserve its productive ability and to the matter of negotiating

Q. In other words, you, as Mr. Patrick's attorney, considered it quite important that he acquire voting control of the Herald Publishing Company?

A. I did and if you will examine the Stipulation which is filed in the record, you will see that it reflects that the control is about all he got in that his purchase of the stock was on a basis which limited his right, or for all practical purposes denied his right, to sell it and assured that it would eventually pass to his children.

[fol. 38] Q. So actually during the course of the settlement negotiations you hoped to gain control of the newspaper for Mr. Patrick?

A. No, sir, I could not say that that was what I felt was being done. It was my view that we were seeking to maintain a control (p. 13) which had theretofore existed by virtue of the marital relationship, but with the severance of the marital relationship would cease or could cease to exist, and that it was more the matter of maintaining status quo rather than creating a new status which was being undertaken.

Q. Did Mr. Patrick's stock when added to that of his son's stock exceed that held by Mrs. Patrick in her individual capacity?

A. If the two had been placed together they would have exceeded her stock.

Q. Did the son, Hugh Patrick, cooperate with his father to the extent that he agreed that the corporation should pay the $16,000.00 item of attorneys' fees for his father?

A. I feel that I should state and analyze what happened and you and the Court will have to judge as to the nature of cooperation. There was involved not only the matter of payment of fees, as you express it, for Mr. Patrick, but for Mrs. Patrick as well in that half of the $16,000.00 went to her attorneys. Furthermore in view of the reimbursement agreement which Hugh Patrick required of his father, I think there might be some question as to whether that would be classified as cooperation or self protection.

Q. During the course of the settlement negotiations did you become familiar with Mr. Patrick's overall financial [illegible]

settlement of a divorce action in which the wife gave up her community property right to one-half of the stock in a lumber company owned by the husband and from which he derived his taxable income. After deciding that the weight of authority favored the deduction, as in the *Bigoy* and *Baer's cases, supra*, the court said that the fact that the payments in question were made to the wife's attorneys rather than to the husband's was inconsequential and said, "We do not think that the fact that the payment here was made to the wife's attorney has any determinant force. * * * The ultimate and only fact before the Tax Court and before us was and is whether the $7,500 was actually paid to the attorney in connection with the saving of the business in which the [fol. 53] husband was interested. * * * *." In other words, the domestic dispute furnished the occasion, but not the motive, for the payment of the $7,500 to the attorney."

The only case in which this question has come before the Fourth Circuit Court of Appeals is *Richardson v. Com. of Internal Revenue*, (C. A. 4), 234 F. 2d 248. There the court disallowed $7,500 in attorney's fees on the ground that the legal services were rendered to prevent the imposing of liability on taxpayer for the wife's support. The court in that case, however, distinguished it from the *Baer* case and inferentially approved the holding in the *Baer* case.

In my opinion, the facts in this case show that the *Baer* case is applicable to this case. The divorce suit could not have been (p. 6) defended on its merits. There were no disputed questions of fact as to the grounds for divorce in South Carolina, or as to the custody of the minor children. The only questions presenting serious difficulties were those pertaining to the property settlement and the apportionment of jointly owned property. If Paula M. Patrick had retained her 28 percent stock interest in Herald Publishing Company and had continued to own, as trustees, a one-half interest in the stock held in trust for her two minor children, Wayne and Paula Elizabeth, and had paid the support of her adult son, Hugh, she would have controlled the publish-

A. To a limited extent, yes.

Q. In dollars and cents what was the chief source of Mr. Patrick's income in 1956?

A. According to my best recollection his chief source of income was from earnings on investments.

[fol. 39] Q. Other than the Herald Publishing Company? (p. 14)

A. I could not say that my recollection is that fine on the subject. I would say that as to compensation or salary, that certainly the investment aspects of his income were the major factor, but what relationship there was between income from the Herald Publishing Company and other income from other investments I do not actually recall. I would assume that the tax returns filed for that year would give you an ample and far better answer to that question than I can give.

Q. Since you have stated that you know of no threat made by Mrs. Patrick against the continued operational control of the Herald by Mr. Patrick, am I correct in assuming that a share of big board stock, let us take Standard Oil for example, of equal value to a share of Herald Publishing Company stock would have been just as satisfactory to Mrs. Patrick?

A. I would answer that question definitely in the negative and I will tell you why. Mrs. Patrick definitely had substantial financial worth in her own right. I never considered it to be a part of her thinking that she was seeking anything particularly for herself. On the other hand circumstances were then such that there was little question but what Mr. Patrick would become remarried if and when he became divorced and this did in fact occur. The chief effort of Mrs. Patrick seemed to be directed towards assuring that as much as possible of Mr. Patrick's financial worth was in some way set aside and blocked off and assured of eventual passage to the children. One of the children, Hugh Patrick, was then and I believe now is in the newspaper business. Another son, Wayne Patrick, was attending the University of South Carolina and I understand was studying or planning to study journalism. I know he had from time to time done some work locally with the paper. It was my understanding that while Mrs.

Patrick was willing to part with immediate control in favor (p. 15) of Mr. Patrick, for which she demanded and [fol. 40] obtained what was then considered to be full and fair value, she nevertheless imposed the requirement on him that he retain and earmark his ownership in such way as to pass the stock eventually to the children. I am therefore convinced that she had a definite and special interest in the Herald Publishing Company stock as such and would not in any sense have considered some other blue chip stock of equal monetary value to be acceptable by way of direct exchange with no limitation.

Q. Mr. Patrick, during the course of his testimony before the Federal District Court, stated that he had no objection to his Herald Publishing Company stock reverting to his children. Is that your interpretation of his position taken during the settlement negotiations?

A. I would say definitely yes. The settlement stipulation which he signed and was a party to definitely so provided.

Q. Then Mrs. Patrick had no objection to Mr. Patrick's retaining the voting control of his stock during his life, is that correct?

A. She agreed to concede him that control in exchange for payment of somewhere in the range of $112,000.00

Q. This $112,000.00 was paid in the form of various blue chip stocks, was it not?

A. That is correct. There may have been some small adjustment by way of cash. I believe I have previously pointed out that that was considered to be the fair value of the Herald stock at that time despite the imposition of limitation on ownership.

Q. Am I correct in assuming that Mrs. Patrick did not desire control of the paper for herself?

A. I would say that that is correct and consistent with the statement that I previously made that she seemed to be seeking something for the children rather than for herself.

(p. 16)

Q. And Mr. Patrick had no objection to the children receiving this control after his death?

(fol. 41) A. I would say that the fact that he [illegible] such an arrangement would be [illegible] of the fact that he did not object thereto.

Q. Who represented the newspaper during the course of these negotiations?

A. Do you mean generally or do you mean with reference to the negotiations?

Q. With reference to these negotiations and [illegible] settlement.

A. No counsel participated in that phase of the matter other than the counsel of record in the divorce action, so far as I know. I do know that Mr. Robert M. Weeks, Attorney, both prior thereto and subsequent thereto, acted in numerous other matters for the Herald Publishing Company. I might add that I have at one time or another acted in certain other matters.

Q. Was there any attorney representing the newspaper as such during the course of the negotiations which terminated in the latter's paying $[illegible] to [illegible]?

A. It is my view and understanding that in acting for the officers of the corporation in their individual capacities and in their capacities as corporate officers that counsel on both sides were in fact undertaking to protect the legal requirements of both the corporation and the individuals concerned, in reference to the matters under negotiation.

Q. Did Mr. Patrick execute any [illegible] or evidence of a debt to the corporation for the $[illegible] payment of legal fees by the corporation?

A. I would not say that I know [illegible] can only say that I do not have any personal knowledge, but I cannot say whether it was or was not done. It is my understanding that there was [illegible] sort of the reimbursement agreement that he made with Hugh Patrick. I do not know in what form, but I believe it may have been by way of [illegible] program, but I am not sure.

Q. [illegible] Mr. Patrick's counsel, may we strike the (fol. 42) services you performed for him to [illegible] minimize the cost to the taxpayers, Mr. Patrick's settlement of his family difficulties?

A. No, sir, I would not so describe the services. Mr. Patrick never indicated any lack of willingness to try to do what he believed to be fair in the matter of discharge of such financial obligations as he owed to his family.

Q. Then the principal services you performed were in seeking to acquire control of Mrs. Patrick's shares in the Herald Publishing Company for the benefit of Mr. Patrick?

A. I would say that, to permit me to use my own words rather than yours, I considered the chief service to be one of protecting and maintaining a status of control which he had theretofore enjoyed and exercised with reference to the corporation, and that in order to do so it was necessary to acquire the stock of Mrs. Patrick and that in buying it and acquiring it by desire to protect the children resulted in his gaining control alone without unrestricted ownership in return for payment of full and fair value. Necessarily these kind of factors made the negotiations difficult and extended.

Q. You felt that this was necessary in spite of the fact that Mrs. Patrick had made no threat against Mr. Patrick's continued operational control of the Herald?

A. I believe that the reference which I made to that subject included the use of the word "immediate" threat. Regardless of the fact that there was no immediate threat, it was completely impossible to determine with any degree of certainty what the future relationship of the parties might be assuming that divorce went through and assuming that Mr. Patrick became remarried over the apparent objections of both his wife and his children and on this account it was considered to be of vital importance to eliminate the possibility of future trouble even though there was no immediate threat at the moment.

(p. 187 ff.)

Mr. Goodhart: I have no further questions.

(fol. 431) *Mr. Ward:* Mr. Spencer, the Amended Stipulation and Settlement which finally resulted in this case has been filed in the record along with a stipulation of facts. Did that final settlement which we have discussed here evolve from the first proposals of the parties or

where there proposals and counter proposals and extended negotiations in arriving at the final settlement?

A. It definitely was not the initial proposal and there had been many proposals and counter proposals and many amendments, and even the document as finally filed in the form of and is entitled Amended Stipulation and Agreement.

Mr. Vasciades: Mr. Spencer how much time and effort was required to convince Mrs. Patrick to relinquish her control of her 28 percent of the stock in Herald Publishing Company?

A. As will be seen by the agreement finally made she never agreed to a complete and unrestricted disposition of her stock and it was only by means of buying it at full value and still in effect not owning it and earmarking it for eventual passage to the children that it was possible to get Mrs. Patrick to release it at all. Therefore this definitely constituted a problem of considerable extent in the negotiations.

(Caption Omitted)

DEPOSITION OF JOHN H. LUMPKIN, ESQ.

Appearances:

For Plaintiffs: Robert M. Ward, Esq.
Rock Hill, S. C.

For Defendant: L. W. Vasciades, Esq.
Washington, D. C.

(p. 2)

DIRECT EXAMINATION BY MR. WARD

Q. Mr. Lumpkin, will you state your name and address for the record?

[fol. 44] A. My name is John H. Lumpkin and I reside and practice law in Columbia, South Carolina.

Q. In what capacity did you appear in the divorce action of Talbot Patrick and Mrs. Paula M. Patrick?

A. I was employed as attorney for Mrs. Paula M. Patrick in that action.

Q. Could you state generally what the issues were in that action?
(p. 3)

A. Mr. Ward, I want to be very careful in my answers this morning so as not to violate any relationship confidential relationship between my client, Mrs. Patrick, and myself, as her attorney, and for that reason I will limit my answers within reason to matters which are of public record. Since the pleadings are on public record, I can state that the action was brought by Mrs. Patrick seeking a full and complete divorce from Mr. Patrick, based on the ground of adultery.

Q. I understand your position, and if I ask any question which you feel you cannot answer, I wish you would so indicate.

A. I shall do so. Incidentally, as I understand my testimony today, my deposition is by direction of the Court. Is that correct?

Q. Yes sir. Now Mr. Lumpkin, did the plaintiff in that divorce action seek anything other than just an absolute divorce?

A. My recollection of the complaint indicates that she also asked for custody of the children, of the minor children, and I believe that's about all. The complaint will speak for itself. She also asked in her complaint for an equitable division of the various properties and assets jointly owned by the parties to the action, including an appropriate property settlement for her needs, and for attorney's fees to be paid by defendant.

Q. What total period of time if you recall, was involved in this matter from the commencement until it was concluded?
[fol. 45] (p. 4)

A. This matter was commenced in the early Fall of 1955 and continued until the late summer or early Fall of 1956.

Q. What occupied the most of your time and the time of Mr. Spencer, representing Mr. Patrick, in the course of handling this matter?

A. I think I can safely say, after reviewing my file, that the vast majority of that time was spent in negotiat-

ing with Mr Spencer and his client, some means whereby the joint's held interests in the Herald Publishing Company, and the business real estate primarily, would be set up in such a way as to allow Mr Patrick to retain control of the operation of the newspaper as publisher, but to prevent him from disposing of those holdings to the detriment of his children.

(p. 5)

Q. Mr. Lumpkin, did Mrs. Patrick at any time question Mr. Patrick's right, title or interest in the shares he held in his own name individually, those shares of the Herald Publishing Corporation?

A. I think not.

Q. Was it as a part of the settlement proposal that your fees for representing Mrs. Patrick were to be paid by Mr. Patrick?

A. Of course, Mr. Vassilades, we prayed for attorney's fees in the Complaint, and it was understood from the very beginning, I think, that we would insist upon our fees in accordance with that prayer. I don't say and I do not believe that they entered into it any way, independent negotiations in connection with the settlement.

Q. And is it your feeling that you would have received the (p. 6) Attorney's fees independent of any settlement negotiations?

A. That's a difficult question to answer because obviously our fees would have been entirely different in amount had the matter been limited solely to a simple [fol. 46] question of divorce or no divorce. Our fees were measured, I think, from the standpoint of the Defendant's attorneys and Plaintiff's attorneys, measured by the time spent in our respective offices in connection with these negotiations.

Q. During the course of your representation of Mrs. Patrick, did you become familiar with the general overall financial position of Mr. Patrick?

A. No sir. I might qualify my answer to this extent, if I may. From the standpoint of economics of the situation, which were qualified by the question of maintaining a successful publishing business, we were interested primarily in a fair and proper allocation and protection of

my client's interest in the Herald Publishing Company and the business real estate, and the method whereby the Defendant's interest would be sufficiently tied up so as to protect the children and yet allow him to continue in his successful position as Publisher. It was to our best interests to do that as we saw it.

Q. Then as I understand your answer, Mrs. Patrick was primarily interested in retaining control of the paper after Mr. Patrick's death, in such a way that her children would inherit that portion? To state it differently, in such a way that her (p. 9) children would acquire control of the paper after Mr. Patrick's death?

A. There was a dual interest. In part, you're right. To that extent you're right but there was also a current interest in continuing the management of that paper in the same individual who had proved a success in its management.

Q. This individual being Mr. Patrick?

A. Mr. Patrick.

Q. And Mrs. Patrick desired that Mr. Patrick continue his control of the newspaper during his lifetime?

A. I can't say that for Mrs. Patrick. I don't know actually.

Q. You, on her behalf, were negotiating with that end in mind?

A. I'm trying to recollect as precisely as possible, which is the reason for my pause, the background and the [fol. 47] reasons for the final stipulation. Certainly in part it was as stated by you, to tie up his interest thereby protecting the children. Certainly in part it was to continue him in active management of the newspaper and to provide that if he should dispose or could dispose of his interest, the children would be protected, and finally I think a very cogent reason in these negotiations as culminated in the Stipulation, was to continue him in an income producing status.

Q. Mr. Lumpkin, are you speaking of the negotiations as a whole, or the aims which you were striving for as Mrs. Patrick's attorney?

A. I might say these are almost joint aims as between Mr. Spencer (p. 10) as attorney for the Defendant and by me as Attorney for the Plaintiff.

Q. Mr. Spencer, during the course of the Deposition, stated that there was no immediate threat against Mr. Patrick's continued operation or control of the Herald. Would you agree with that statement?

A. Yes sir I think I would agree to that.

Q. We were also informed during the course of Mr. Spencer's deposition, that Mr. Patrick did not object to his children receiving his stock or interest in the newspaper at the time of his death. Would you agree with that statement?

A. I don't know. Through his attorney, he agreed to it.

Q. Are you familiar with Mr. Patrick's income to such an extent that you could compare the receipts he personally received from the Herald Publishing Corporation, either as salary or dividends, with his other items of income?

A. I am not sufficiently familiar to answer that intelligently.

Q. Could you tell us whether or not Mr. Patrick had other items of income?

A. I feel sure he did because the record will show that he funded a Trust with other stocks.

Q. Were those other stocks of income, of a greater amount than the income he received from the publishing corporation?

A. I have no idea.

[fol. 48] Q. Now what did Mrs. Patrick receive as an end result of those (p. 11) (settlement negotiations, and by receipt I refer to financial?

A. Well sir I think the record speaks for itself on that because as I recollect there was nothing not in the stipulation, which should have included all items which would be income pertaining to her. I would prefer not to try to itemize them because I'm not sure I could remember everything but my recollection is that the Stipulation will show that.

Q. But it is your recollection that the retention of operational control of the newspaper by Mr. Patrick, was a joint aim of both yourself as Mrs. Patrick's attorney and of Mr. Spencer as Mr. Patrick's attorney?

A. Yes I think it was a joint aim to this extent: I think both of us felt that it was quite necessary, if he was to

continue to publish and manage the paper, that he not only have control so to speak, but also that he be remunerated for that control on an appropriate basis. We couldn't very well expect him to continue in that status without protecting his income to that extent.

Q. Mrs. Patrick at all times was agreeable with this view?

A. The stipulation was signed by her so I assume that she was.

IN UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF SOUTH CAROLINA

OPINION, FINDINGS OF FACTS, CONCLUSIONS OF LAW AND ORDER—June 22, 1960

This is an action to recover income tax in the amount of $21,673.73 paid by taxpayers for the year 1956, under alleged erroneous and illegal deficiency assessments.

The action is brought in the names of Talbot Patrick, individually, and Commercial Bank of Charlotte, North Carolina, as Administrator of the Estate of Alethia M. Patrick, deceased, since the 1956 return, sued on, was a joint return.

[fol. 49] The record in this case includes the pleadings, testimony of Talbot Patrick, depositions of C. W. F. Spencer, Jr., Esq. and John H. Dumpkin, Esq., taxpayers' income tax return for the calendar year 1956, and a stipulation of counsel for both parties which incorporates a property settlement agreement, a trust agreement, and taxpayers' claim for refund of the taxes now sued for.

Taxpayer Talbot Patrick was sued for divorce by his then wife Paula M. Patrick on December 16, 1955. The complaint sought an absolute divorce, court supervision of division of properties, an appropriate property settlement in favor of the wife, custody of the children of the marriage and counsel fees. Talbot Patrick filed an an-

swer which neither admitted nor denied the allegations of adultery, claimed as the ground for divorce. He did not offer testimony at the hearing. While the divorce action was pending, counsel for the parties carried on extended negotiations on the question of property settlement, which ultimately resulted in the agreement which is incorporated in the stipulation by counsel in this case. The Court of Common Pleas for York County issued its final decree of absolute divorce, approving the property settlements theretofore made, and, by reference, requiring the payment by Talbot Patrick of counsel fees. These fees, by agreement of counsel and the parties, were $12,000 for each of the two law firms involved, a total of $24,000, and were allocated $4,000 for the handling of the divorce, $4,000 for the handling of the business, real estate, and $16,000 for the re-arranging of stock ownership and control of the Herald Publishing Company. Of the $4,000 charged for the handling of the business and estate settlement, $3,200 was charged against Talbot Patrick, who theretofore had owned four-fifths undivided interest in same, and $800 was charged against Paula M. Patrick, who had owned one-fifth thereof. The $800 is not an issue in this case. In April 1958, the Internal Revenue Service disallowed Talbot Patrick's claim of $3,200 shown on the 1956 return as a business expense. [fol. 50] which is a part of the tax which taxpayers seek to recover in this action.

Prior to the payment of any of the attorneys' fees, there was an agreement among all the stockholders and officers of Herald Publishing Company that $16,000 of the attorneys' fees would be paid by Herald Publishing Company under a proviso that if this was not allowed as a business expense deduction by the corporation, it then would be repaid to the corporation by Talbot Patrick. In January, 1959, the Internal Revenue Service rejected the deduction of the $16,000 as a business expense by the corporation as not being a proper corporate expense. The corporation paid an additional tax of $8,320. The Internal Revenue Service then designated the $16,000 a dividend to Talbot Patrick and he was required to pay income tax (p. 3) thereon. This is a part of the tax which taxpayers seek to recover in this action.

In 1959, pursuant to the 1956 commitment, Talbot Patrick paid back to Herald Publishing Company the $16,000 with interest. Taxpayers' claim that this was a 1956 deductible business expense of Talbot Patrick was disallowed. This also is a part of tax for which taxpayers sue.

There is a further small item of adjustment of allowable medical expense set out in the claim and the complaint.

In May 1959, taxpayers filed with the Internal Revenue service timely claim for refund of $21,675.73, with interest, which was rejected, and this suit was then instituted.

The $16,000 in attorneys' fees paid by Herald Publishing Company in 1956, and, by prior agreement, repaid to Herald Publishing Company by Talbot Patrick in 1959, in my opinion, was not a dividend to Talbot Patrick.

Talbot Patrick had a legal duty to pay these attorneys' fees. Paragraph 11 of the "Amended Stipulation and Agreement" between the parties to the original action, required Talbot Patrick to pay plaintiff's attorneys' fees, and, he, of course, had a duty to pay his own counsel. [fol. 51] This agreement was adopted, confirmed, and made a part of the court's final order in the divorce decree. The $16,000 was charged against the corporation under an agreement that if allowed as a proper corporate deduction, it would be repaid by Talbot Patrick. This repayment agreement was made prior to payment of the fees by the corporation and the sum was repaid by Talbot Patrick to the corporation.

Where there is an intent to repay an advance by a corporation to pay a stockholder's obligation it is treated as a loan and not as a constructive dividend. *Ortmayer* v. *C.I.R.*, (CA 7), 265 F. 2d 848.

In this case there is no question of intent to repay. Further, the agreement to repay the corporation was not a retroactive device (p. 4) to minimize taxes, but was made prior to the payment of any part of the funds by the corporation, and Talbot Patrick received no ultimate benefit from the transaction. *Rosencrans* v. *Commissioner*, 13 TCM 176.

In my opinion, the $16,000 was a loan and not a dividend.

The $3,200 and the $16,000 paid by Talbot Patrick as attorneys' fees were deductible as expenses incurred for the management, conservation or maintenance of property held for the production of income.

Adultery is a ground for absolute divorce in South Carolina, and Talbot Patrick made no defense. His wife was entitled to a substantial property settlement and all of his property was at risk until settlement was made. Only $4,000 of the attorneys' fees were allocated to be the question of divorce, and those fees were properly treated as personal expenses and not claimed as deductible, nor was any of the property settlement or support claimed as deductible.

The $3,200 in fees were charged for, allocated to, and paid for the services rendered by counsel in the settling of the question of division of the business real estate in such a way as to maintain its uninterrupted use by the newspaper publishing company. After the settlement (fol. 52), Talbot Patrick did not own the four-fifths interest therein, that passing into a trust, from which the newspaper was obliged to lease. This amount of fees was deductible by Talbot Patrick.

The $16,000 was charged for, allocated to, and paid for the services of counsel in negotiating a property settlement which resulted in Talbot Patrick's being able to retain actual control of the newspaper corporation, together with his salary as an officer and as editor and publisher. The stock which he found it necessary to buy in order to maintain this actual control had a peculiar and special value to him in this situation, and he paid full value for it but received only the control and use of the stock, with ownership tied up for his children.

When a wife makes reasonable claims which threaten the husband with the loss of his source of taxable income, the amount of the fees paid to the attorneys which are allocable to the settlement of the wife's claim is deductible. *Bowers* v. *Commissioner of Internal Revenue*, (CA 10), 243 F. 2d 904; *Baer* v. *Commissioner of Internal Revenue*, (CA 8), 196 F. 2d 646.

In *Owens* v. *C.I.R.*, (CA 5), 275 F. 2d 251, 256, the court allowed as deductible a legal fee of $7,500 paid by the husband to the wife's attorneys in working out a

ing company and could have discharged the taxpayer Talbot Patrick from his salaried positions as president of the publishing company and its editor and publisher. This would have imposed upon Paula M. Patrick, however, the responsibility of providing the corporation with competent leadership and continuing the newspaper in Rock Hill. Paula M. (p. 6) Patrick and her attorneys, after surveying the field, thought that the present management of the corporation and the editorial policies of the newspaper were sound, and entered into a stipulation and settlement which preserved Talbot Patrick's taxable income. Taxpayer Talbot Patrick's liability for the attorneys' fees claimed would not have been incurred except [fol. 54] for these problems relating to his income and income-producing property.

The claim by the Government that the $16,000 in attorneys fees cannot be claimed as a deduction by the taxpayer for 1956, because not paid in the tax year 1956, is fallacious.

If it were held that this was a constructive dividend to Talbot Patrick, then it passed to him in the year 1956, and paid the legal fees for which he was obligated.

The $16,000 was a loan to Talbot Patrick which was paid out in his behalf in 1956, and the payment of the $16,000 by Talbot Patrick in 1959 amounted to a repayment of this only and is not to be confused with the actual payment of the fees in the tax year 1956.

Generally such a question as is here presented is raised when a taxpayer attempts to claim in a subsequent year deductions which are held to have been paid in the year the expense actually was incurred, and the decisions have uniformly allowed such deductions only in the year in which the debt actually was paid or was incurred.

It has been held many times that when deductible expenses are paid by a cash basis taxpayer with borrowed funds, or paid on his behalf by someone else, when he is obligated to repay, the expenses must be deducted in the year they were paid and not when the borrowings or loans were repaid. *A.W.D. Weis* v. *Commissioner*, 13 BTA 1284; *B. B. Keenan* v. *Commissioner*, 30 BTA 498. A recent case precisely in point is *Sinall* v. *Commissioner*, 30 TC 734. There taxpayer's controlled corporation paid

a legal fee, for working on a tax case against the taxpayer, in 1947, and claimed that the legal fee was a corporate tax deduction for that year. This claim was disallowed. In 1950, the taxpayer repaid the amount of the fee to the corporation and claimed the deduction personally for that year. The court said that whether the transaction was a loan or a constructive dividend, which was used by the taxpayer to pay the legal fee, [fol. 55] the payment of the fee was in 1947, and the deduction would be proper only in that year, not in 1950.

The $16,000 was a proper business expense deduction for Talbot Patrick for the year 1956, and should be so allowed.

For the foregoing reasons, it is my opinion that plaintiffs' claim for refund should be allowed.

This opinion will stand as the findings of fact and conclusions of law in this cause under Rule 52(a), Rules of Civil Procedure.

Plaintiffs are therefore entitled to judgment in an amount to be computed by the Internal Revenue Service in accordance with findings of fact, conclusions of law and order herein, together with interest thereon, and

IT IS SO ORDERED

C. C. Wyche
United States District Judge

Dated:

Spartanburg, South Carolina
June 22, 1960.

IN UNITED STATES DISTRICT COURT

Notice of Appeal

Notice is hereby given that the United States of America, defendant above named, hereby appeals to the United States Court of Appeals for the Fourth Circuit from the Order of the United States District Court for the Western District of South Carolina entered June 23, 1960.

Joseph E. Bixes
United States Attorney
Greenville, S. C.
Attorney for Appellant,
United States of America

Greenville, S.C.
August 19, 1960.

[fol. 56] • • • • •

[fol. 57] IN THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

APPENDIX TO BRIEF FOR THE APPELLEES

[fol. 58] * * * *

[fol. 59]

IN UNITED STATES DISTRICT COURT

TRANSCRIPT OF PROCEEDINGS IN DISTRICT COURT

DIRECT EXAMINATION OF TALBOT PATRICK

BY MR. WARD:

(Tr. 10)

Q. At this time, in 1955, when this action was commenced, were you or not employed in any other position other than as editor and publisher of the *Herald*?

A. No, sir.

Q. Did you draw any salary from any other source?

A. No, sir.

(Tr. 37)

Q. Going back one more moment to the income tax return about which counsel asked you, I believe you testified your salary from the Herald and your corporate earnings were about $15,000.00?

A. Yes, sir.

Q. And, then there was a dividend in addition to that?

A. Yes, sir.

Q. Now, did you or not consider that an important part of your income, Mr. Patrick?

A. I considered it an important part because of its bearing on the future.

Q. Have you made any progress in the building of this newspaper since you have taken it over?

A. Yes, sir. I took it over the first of July, in 1947. It

(Tr. 38)

then had seven thousand circulation. By the fall of 1955, it had nearly eleven thousand and I felt that I

could continue to develop it further; so that is a fact, today it has more than thirteen thousand.

Q. As a matter of fact, was that salary you drew relatively low in the field of publishing newspapers of this size?

A. I happen to know that publishers, editors and publishers of similar size properties at that time were getting [fol. 60] about twenty-four or twenty-five thousand dollars a year salary.

Q. Was this salary you were talking about, was that the whole test of the value of the Herald to you, Mr. Patrick?

A. No, sir, I was building up a property and I anticipated that in the future both salary would be higher and value of the property would be higher.

DEPOSITION OF C. W. F. SPENCER, JR.

(P. 5)

By Mr. WARD:

Q. Mr. Spencer, by his words and his actions with which of these parties did the sympathy of the son Hugh Patrick lie?

Mr. CASTLANOS: I would like to note an objection to that question as it calls for a conclusion by Mr. Spencer based on the mental operations of the son. We would have no objection to Mr. Spencer testifying as to the specific acts which might indicate the feelings of the son.

A. It is difficult for me to go back some five years and recall specific or detailed acts or conduct on the part of an individual child with reference to the subject of the question asked. I cannot at present bring to mind any positive or specific incident or occurrence. I do recall generally that in my representation of Mr. Patrick the children were never

(P. 6)

involved to any extent or degree in reference to the matters of any sort of direct participation in his behalf. On the other hand, I recall rather positively that the sons were frequently involved on the other side on behalf of their mother. I do not mean by this to indicate that

I was personally present at joint conferences between Mrs. Patrick and her counsel and her children. However, I was personally aware of arrangements for such conferences from time to time. Proceeding now to answer directly the question asked by Mr. Ward as to my opinion, which answer I understand to be directly subject to objection by opposing counsel, it was my opinion at the time that Mr. Patrick was definitely in what might be called a lone wolf category and that Hugh Patrick [fol. 61] and the other children were definitely sympathetic and aligned with their mother and against their father in the controversy then pending between the two of them.

Q. Mr. Spencer, did Hugh Patrick ever confer with you and or offer any assistance to his father in this matter?

A. I recall no such occasion.

DEPOSITION OF JOHN H. LUMPKIN

By Mr. Ward:

Q. The record shows that the attorneys' fees in this matter totaled $24,000.00. Can you testify as to the allocation of those fees as they applied to the services rendered in the different issues in this matter?

A. Mr. Ward, my recollection of the allocation would be as follows: Of the $24,000.00, $4,000.00 was allocated to the divorce itself and the balance of our fee was allocated to the time spent in arriving at the final stipulation which has been recorded with the Clerk of Court of York County. This stipulation embraced the final conclusions that we were able to reach as to how to accomplish the end which I have just described.

Q. Mr. Lumpkin, in the course of this case there have been some questions as to the position taken by Mr. Haigh Patrick the son of Mr. and Mrs. Patrick, who owned 9% of the stock of the Herald Publishing Company. Can you testify as to whether or not he was with his mother or his father in this controversy?

Mr. VASELIADES: I would like to note an objection to that question, as calling for a conclusion by Mr. Lumpkin, as to the mental state of Mr. Hugh Patrick.

A. Mr. Ward, I would prefer not to answer that question as to his mental attitude. I think I can safely state factually that he conferred with me and I conferred with him regularly as this matter progressed.

(P. 11)

Q. Mr. Lumpkin, except for the success of the negotiations in this matter, could it have resulted very differently for Mr. Patrick?

[fol. 62] Mr. Vasiliades: I object to that question as calling

(P. 12)

for any number of conclusions, which I don't think we should go into at this time.

A. Well, I think you know, Mr. Ward, and all of us know as practicing attorneys, a great many alternatives are considered in a situation such as this.

[fol. 63]

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 8259

TALBOT PATRICK and COMMERCIAL BANK OF CHARLOTTE, Administrator of the Estate of Alethia M. Patrick, deceased, APPELLEES

versus

UNITED STATES OF AMERICA, APPELLANT

Appeal from the United States District Court for the Western District of South Carolina, at Rock Hill

DOCKET ENTRIES

November 21, 1960, record on appeal filed and appeal docketed.

November 21, 1960, transcript of testimony filed.

November 21, 1960, depositions (2) and defendant's exhibit A received from the Clerk of the United States District Court.

November 21, 1960, appearance of Charles K. Rice, Assistant Attorney General; Lee A. Jackson, Attorney, Department of Justice, and Joseph E. Hines, United States Attorney, entered for the appellant.

November 29, 1960, appearance of Robert M. Ward entered for the appellees.

December 1, 1960, motion of appellant for extension of time to file brief filed.

IN UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT.

ORDER EXTENDING TIME FOR FILING BRIEFS AND APPENDICES. Filed December 5, 1960.

Upon the motion of the appellant, by its counsel, and for good cause shown,

[fol. 64] It is ordered that counsel for the appellant serve upon counsel for the appellees typewritten copies of its brief and appendix by December 12, 1960, and furnish four typewritten copies to the Clerk of this Court, and that printed copies be filed as soon thereafter as possible.

Further ordered that the time for the filing of appellees' brief and appendix be, and it is hereby extended from December 22, 1960, to and including January 3, 1961.

December 5, 1960.

SIMON E. SOBELOFF
Chief Judge, Fourth Circuit

December 30, 1960, brief and appendix for appellees filed.

January , 1961, brief and appendix for appellant filed.

January 25, 1961, appearance of Arthur . Gould, Attorney, Department of Justice, entered for the appellant.

IN UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

MINUTE ENTRY OF ARGUMENT & SUBMISSION

January 25, 1961, cause came on to be heard before Soper and Haynsworth, Circuit Judges, and Lewis, District Judge, and was argued by counsel and submitted.

[fol. 65]

IN UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 8259

TALBOT PATRICK and COMMERCIAL BANK OF CHARLOTTE, Administrator of the Estate of Alethia M. Patrick, deceased, APPELLEES

versus

UNITED STATES OF AMERICA, APPELLANT

Appeal from the United States District Court for the Western District of South Carolina, at Rock Hill
C. C. Wyche, District Judge

(Argued January 25, 1961)

Before SOPER and HAYNSWORTH, Circuit Judges, and LEWIS, District Judge.

OPINION March 27, 1961

Arthur H. Gould, Attorney, Department of Justice, (Charles K. Rice, Assistant Attorney General; Lee A. Jackson and Melva M. Graney, Attorneys, Department of Justice, and Joseph E. Hines, United States Attorney, on brief) for Appellant, and Robert M. Ward for Appellees.

[fol. 66] LEWIS, District Judge:

This is an action to recover income taxes paid under a deficiency assessment arising from the disallowance of a deduction for legal fees paid to taxpayer's and his former wife's attorneys for services rendered in connection with a property settlement incident to a divorce of the parties.

The District Court for the Western District of South Carolina, hearing the case without a jury, sustained the contentions of the taxpayer, 186 F. Supp. 48, and the Government appealed.[1]

We adopt the findings of fact by the District Court which are substantially as follows:

The taxpayer was sued for divorce. The wife sought an absolute divorce, court supervision of the properties, a property settlement, child custody and attorney fees. The taxpayer neither admitted nor denied the alleged grounds for divorce. He did not testify at the trial. Extended negotiations were carried on by attorneys for both parties, culminating in a property settlement. The trial court in South Carolina granted the wife an absolute divorce, approved the property settlement and ordered the taxpayer to pay all attorney fees for both parties, provision for which had also been previously agreed upon.

At the time of the institution of the divorce proceedings and for some years prior thereto the taxpayer was the operating head of the Herald Publishing Corporation. He owned 28% of the stock and his wife owned 28%. [fol. 67] The eldest son owned 9% and the balance thereof was held in trust for the use and benefit of the children. The only other income-producing property was real estate (a building mainly occupied by the publishing corporation). The taxpayer had an 80% undivided interest therein and the wife had a 20% undivided interest.

The pertinent portion of the settlement agreement provided the taxpayer would purchase the wife's 28% interest in the publishing corporation stock at fair market price.

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[1] The Government did not appeal the constructive dividend issue decided in favor of the taxpayer.

conditioned upon the further agreement that the stock acquired from the wife, together with the taxpayer's stock in the publishing corporation (50%) would pass to the children on his death, or if the stock was sold prior thereto, the proceeds would become the property of the children. The undivided interests of the taxpayer and his wife in the income producing real estate were placed in trust for the children, subject to a lease to the publishing corporation for a term of years.

The attorney fees incurred by the parties for the divorce action and settlement agreement were $12,000.00 each, or a total of $24,000.00, $4,000.00 of which was for handling of the divorce, $1,000.00 for placing the real estate in trust, $8,000.00 of which was charged to the taxpayer and $7,000.00 to the wife, and $19,000.00 for the rearranging of stock ownership and control of the Herald Publishing Corporation. Prior to the institution of the divorce proceedings the taxpayer, because of family unity, controlled the publishing corporation and was editor and publisher of the newspaper and drew salaries therefrom.

During the pendency of the divorce proceedings there was more than a possibility the control of the publishing corporation would be sold and that the income producing [fol. 65] real estate might be partitioned and or sold. Prospective purchasers of the publishing corporation were interviewed by the wife's attorneys. The wife made no immediate threat upon taxpayer's operation or control of the newspaper and did not seek to expose or encumber his interest therein. The eldest son appeared to favor the mother in the marital difficulties and the wife and children were very much opposed to the apparent remarriage of the taxpayer.

The taxpayer contends that that portion of the attorney fees paid for legal services rendered solely in connection with the property settlement was deductible pursuant to Title 26, United States Code, Section 212 (2), 1954 of

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"Expenses for production of income. In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year

(2) for the management, conservation or maintenance of property held for the production of income."

[fol. 77]

SUPREME COURT OF THE UNITED STATES
No. 236, October Term, 1961

UNITED STATES, PETITIONER

vs.

TALLOT PATRICK, ET AL.

ORDER ALLOWING CERTIORARI. October 9, 1961

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

The District Court found the legal fees in the amount of $3,200.00 and $16,000.00 were reasonable and proximately related to the management, conservation, or maintenance of property held for the production of income and were therefore an allowable deduction to the taxpayer. We agree.

The Government insists however, that legal fees paid in connection with a divorce proceeding, accompanied by a property settlement, are incurred in relation to the dissolution of a personal family relationship, and that Title 26, United States Code, Section 262 (1958 ed.)[1] specifically denies a taxpayer a deduction with respect to a personal or family expense. Such is correct, in those [fol. 69] cases where the expenses incurred were paid for legal services in representing the parties in a divorce proceeding, or in contesting the liability accruing as a result thereof. In this case $4,000.00 in legal fees were incurred in the handling of the divorce proceeding. No deduction or claim therefor was made. The taxpayer incurred additional legal fees in the amount of $3,200.00 for services rendered in connection with the preparation of the trust agreement, and the leasing of the income-producing real estate, of which he owned a 4/5th undivided interest; and $16,000.00 in additional legal fees for the rearranging of the stock ownership and control of the Herald Publishing Corporation.

The Government does not deny the reasonableness of the fees or the necessity therefor. It contends: "While the distinction between immediate purpose and incidental consequence is given effect, attorneys' fees paid in relation to a property settlement under a divorce decree are necessarily nondeductible as being personal expenses, regardless of whether there is an effort by one spouse to maintain and conserve income-producing property". With this we do not agree.

The Eighth, Sixth and Fifth Circuits and Court of

[1] "Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses."

Claims have all reached the opposite result in regard to this question. An examination of those cases indicates the legal fees were allowed as a deduction because they were not expended to resist a liability, but were spent to find a manner in which it could be met without depriving taxpayer of his income or income producing property.

[fol. 70] In the Baer case the Court stated:

> * * * * The controversy did not go to the question of the liability but as to the manner in which it might be met by the petitioner without greatly disturbing his financial structure. * * * *"

In the Bowers case the Court allowed a $45,000.00 attorney fee as claimed, with the statement that, as in the Baer case, " * * * there was little occasion for the services of a taxpayer's lawyers in divorce proceedings proper. * * such services were largely devoted to adjusting the taxpayer's liability to his wife * * *".

In the Owens case the Court stated:

> * * * * * The ultimate and only fact before the Tax Court and before us was and is whether the $7,500 was actually paid to the attorney in connection with the saving of the business in which the husband was interested. * * * * In other words, the domestic dispute furnished the occasion, but not the motive, for the payment of the $7,500 to the attorney."

In the McMurtry case the Court of Claims gave the taxpayer an opportunity to show to what extent legal expenses were incurred in conservation and maintenance of property.

The Government relies mainly upon Lykes v. United States, 343 U.S. 118, and Lewis v. Commissioner, 253 F. 2d 821. Neither of these cases are in conflict with the above cited cases. In the Lykes case deductibility turned

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Baer v. Commissioner, 196 F. 2d 646 (5th Cir.)
Bowers v. Commissioner, 243 F. 2d 894 (9th Cir.)
Owens v. Commissioner, 253 F. 2d 251 (5th Cir.)
McMurtry v. United States, 132 F. Supp. 114 (Court of Cl.)

wholly upon the activities to which they were related. [fol. 71] The taxpayer gave away stock with a fixed value and the Commissioner of Internal Revenue revalued it and assessed a deficiency. The fees were incurred in contesting this deficiency or in resisting liability.

In the Lewis case the Second Circuit refused to allow a deduction of attorney fees on the theory that such fees were spent in resisting legal separation proceedings and liability.

The other cases relied on by the Government in support of its theory are clearly distinguishable in that the facts therein recited are not analogous to the facts in this case.[5]

Richardson v. Commissioner, 234 F. 2d 248 (4th Cir.), likewise does not support the Government's position. In that case this Court stated:

> "* * *. It is clear that the attorneys for the husband expended no effort in the conservation or maintenance of his property, as envisioned by the statute. * * *. Their services were directed to preventing any liability being imposed upon the husband for his wife's support, and it is this for which they were paid. * * * * even if any part of the fees paid by him to his attorneys could be said to be for services in conserving his property, no effort has been made to show what part of the sums paid should be allotted to that purpose * * * unless and until it is shown what part of the sums paid them [fol. 72] are applicable to that part of their efforts there is no basis upon which to grant a deduction.
>
> "* * *. None of the conditions which formed the basis for the decision in the Baer case exists in the case now before us."

Harris v. United States, 275 F. 2d 72;
Tressler v. Commissioner, 228 F. 2d 356;
Howard v. Commissioner, 202 F. 2d 28;
Smith's Estate v. Commissioner, 208 F. 2d 349;
Norton v. Commissioner, 192 F. 2d 960;
Douglas v. Commissioner, 33 T.C. 349;
Donnelley v. Commissioner, 16 T.C. 1199.

The Government further contends however that if this case were pending in a Circuit that had followed the reasoning set forth in the Baer line of decisions, the taxpayer's claim of deduction would not be allowed because the essential factor in the application of those decisions was a threat to income producing property.

It is true the wife, in this case, did not commit an overt act, to either enjoin, damage or encumber the taxpayer's income-producing property. This was not necessary. We conclude that all of the taxpayer's income-producing properties were in great peril until and unless a satisfactory property settlement agreement was concluded.

At the time he was sued for divorce the taxpayer was a stockholder in Herald Publishing Corporation. He owned 28%, his wife 28%, their son Hugh 9%, with 7% additional in trust, and two other children owned 28% of the stock in trust. Because of the family unity which had existed, taxpayer had in fact controlled the Herald operations and had been editor and publisher of the newspaper and a director and president of the corporation and drew salaries therefrom. When the divorce suit was commenced against him practically everything he had was at stake. There was the distinct possibility that control of the corporation would be sold; in fact, the wife's attorneys were approached by prospective purchasers. It was not necessary for his wife to threaten to take from him the Herald stock. The wife, with her 28% own stock and as a trustee jointly controlling the stock of her children, with the support of her son Hugh, controlled the corporation. With the family unity broken this control could have been, and probably would have been, exercised by the wife to the taxpayer's detriment.

Over a period of years he had built up the newspaper and if he lost control his income therefrom would not only have been impaired, it would have been totally destroyed. In addition, upon the entry of a divorce decree the wife acquired the right to partition and or force the sale of the income producing real estate which housed the publishing corporation, thereby jeopardizing its very existence.

The husband had no defense to the merits of the divorce. He did not contest or resist the liabilities accruing to the wife and children and the legal fees claimed as a deduction were not expended for that purpose. They were spent by the taxpayer for services rendered through long and continued negotiations, designed to find a means in which the taxpayer would meet these liabilities without destroying his income and his income-producing status.

The fact that the agreement between the parties was concluded in apparent harmony and without any overt act on the part of the wife to take away, or threaten to take away, the income-producing property of the taxpayer, does not say that there was no risk to the taxpayer. The danger to his income and income-producing property was there until the matter was concluded, and it was not concluded until there was a readjustment of his income-producing holdings.

The Government further contends, however, that even though the legal fees incurred by the taxpayer in main- [fol. 74] taining and conserving his income-producing property are deductible under Code Section 212 (2), the fees paid his wife's attorneys are under no circumstances deductible. The taxpayer's liability for his legal fees and the legal fees for his wife would not have been incurred except for the necessity of the long and extended negotiations culminating in the preservation, maintenance and conservation of the taxpayer's income producing property. They were incurred for that purpose and that purpose only.

The only test of deductibility provided for in the statute is whether or not the expenses were reasonable and proximately related to the management, conservation and maintenance of income producing property. It makes no difference to whom they are paid.

In the Lykes case, supra, the Supreme Court stated:

> "* * * * deductibility turns wholly upon the nature of the activities to which they relate. * * * * *"

And in the Owens case, supra, the Court said:

> "We do not think that the fact that the payment here was made to the wife's attorney has any determinative force. * * * *."

In view of the findings of fact of the District Court and the undisputed testimony in behalf of the petitioner we are of the view, the legal fees in the amount of $1,000.00, which were paid by the taxpayer for the protection and conservation of his income producing property was properly deductible as claimed. The decision of the District Court is accordingly

Affirmed.

[fol. 75]

IN UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 8259

TALBOT PATRICK and COMMERCIAL BANK OF CHARLOTTE, Administrator of the Estate of Alethia M. Patrick, deceased, APPELLEES

vs.

UNITED STATES OF AMERICA, APPELLANT

APPEAL from the United States District Court for the Western District of South Carolina.

JUDGMENT—Filed and Entered March 27, 1961

THIS CAUSE came on to be heard on the record from the United States District Court for the Western District of South Carolina, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

March 27, 1961.

MORRIS A. SOPER
United States Circuit Judge

April 27, 1961, mandate issued and transmitted to the Clerk of the United States District Court at Greenville, South Carolina.

April 27, 1961, record on appeal, transcript of testimony, depositions (2), and defendant's exhibit A, returned to the Clerk of the United States District Court at Greenville, South Carolina.

[fol. 76] Clerk's Certificate to foregoing transcript omitted in printing

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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

TALBOT PATRICK AND COMMERCIAL BANK OF CHARLOTTE, ADMINISTRATOR OF THE ESTATE OF ALETHIA M. PATRICK, DECEASED

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of the United States, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in the above-entitled case.

OPINION BELOW

The opinion of the District Court (R. 48–55) is reported at 186 F. Supp. 48. The opinion of the Court of Appeals (Appendix, *infra*, pp. 13–22) is reported at 288 F. 2d 292.

JURISDICTION

The judgment of the Court of Appeals was entered on March 27, 1961. (Appendix, *infra*, pp. 22–23.) By order of the Chief Justice, dated June 24, 1961, the

time for petitioning for a writ of certiorari was extended to and including July 25, 1961. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Whether fees which a taxpayer-husband paid to his attorney for services rendered in connection with a divorce proceeding—specifically, fees paid for negotiation and effectuation of a husband-wife property settlement—were properly allowed as income tax deductions under Section 212(2) of the Internal Revenue Code of 1954 (authorizing the deduction of "all the ordinary and necessary expenses paid or incurred * * * for the management, conservation or maintenance of property held for the production of income").

2. Whether the taxpayer-husband, having also paid (as directed by the divorce court) legal fees owed by the wife to her attorney for similar services, may deduct those expenses pursuant to Section 212(2).

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1954:

> SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.
>
> In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—
>
> (1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

* * * * * * *

(26 U.S.C. 1958 ed., Sec. 212.)

SEC. 262. PERSONAL, LIVING, AND FAMILY EXPENSES.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

(26 U.S.C. 1958 ed., Sec. 262.)

Treasury Regulations on Income Taxes (1954 Code):

SEC. 1.262-1. *Personal, living, and family expenses*—(a) *In General.* In computing taxable income, no deduction shall be allowed, except as otherwise expressly provided in chapter 1 of the Internal Revenue Code of 1954, for personal, living, and family expenses.

(b) *Examples of personal, living, and family expenses.* Personal, living, and family expenses are illustrated in the following examples:

* * * * * * *

(7) Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either the husband or the wife. However, the part of an attorney's fee and the part of the other costs paid in connection with a divorce, legal separation, written separation agreement, or a decree for support, which are properly attributable to the production or collection of amounts in-

cludible in gross income under section 71 are deductible by the wife under section 212.

STATEMENT

The facts are undisputed and are fully set forth in the opinions of the District Court (R. 48–55) and the Court of Appeals (Appendix, *infra*, pp. 13–22). They may be summarized as follows:

Talbot Patrick (the taxpayer)[1] was sued for divorce in December 1955 by his former wife, Paula M. Patrick. In her complaint, Mrs. Patrick sought an absolute divorce, court supervision of division of the properties, a property settlement, child custody and attorney's fees. Negotiations were conducted by attorneys for both parties and resulted in a property settlement. The court issued a final decree of divorce, approved the property settlement and required the taxpayer to pay all attorneys' fees for both parties. (R. 49; Appendix, *infra*, p. 14.)

The property settlement covered the following: two residences; stock in the Herald Publishing Company (of which the taxpayer was president); and a parcel of real estate which was in part leased by the publishing company. Only the stock in the publishing company and the real estate leased by it were income-producing. (R. 9–13, 44; Appendix, *infra*, pp. 14–15.)

Prior to the property settlement, the taxpayer and his wife each owned 28 percent of the stock of the

[1] The Commercial Bank of Charlotte is party to this proceeding as the Administrator of the Estate of Alethia M. Patrick, with whom the taxpayer filed a joint income tax return for 1956.

publishing company. Their oldest son owned 9 percent outright and an additional 7 percent was held in trust for him. Each of the other two children of the marriage had a 14 percent interest in trust. With respect to the income-producing real property, the taxpayer had an 80 percent undivided interest and his wife had a 20 percent undivided interest. (R. 17, 19; Appendix, *infra*, p. 14.)

The settlement agreement provided that the taxpayer would purchase his wife's 28 percent interest in the publishing company subject to the condition that the stock would pass to the children on taxpayer's death or, if the stock were sold by him, that the proceeds would go to the children. (R. 12–13; Appendix, *infra*, pp. 14–15.) The agreement further provided that the interests of both taxpayer and his wife in the income-producing real property would be placed in a trust, the income from which would go to the wife during her life with remainder to the children. (R. 9–10; Appendix, *infra*, p. 15.)

The attorneys' fees incurred by the parties for the divorce action and settlement agreement were $12,000 each. The total of $24,000 was paid by the taxpayer pursuant to the settlement agreement and divorce decree. The fees were allocated, by agreement of counsel and the parties, as follows: $4,000 for the divorce; $4,000 for placing the real estate in trust ($3,200 of which was charged to the taxpayer and $800 to the wife); and $16,000 for rearranging the stock ownership and control of the publishing company. (R. 34–35, 49; Appendix, *infra*, p. 15.)

In 1956, the taxpayer claimed a deduction of $19,200, representing his share of the fees for placing the real estate in trust and both his and his wife's fees for rearranging the stock interests. The deduction was disallowed by the Commissioner and the deficiency in tax paid. (R. 50–51; Appendix, *infra*, pp. 15–16.) Upon suit for refund, the District Court allowed the deduction (R. 51; Appendix, *infra*, p. 16), and the Court of Appeals affirmed (R. 74; Appendix, *infra*, p. 22).

REASONS FOR GRANTING THE WRIT

Like the decision of the Court of Claims in *Gilmore* v. *United States*, decided June 7, 1961, in which we are concurrently filing a petition for certiorari, this case raises questions as to the deductibility of legal expenses which are incurred in connection with a divorce proceeding. Although there are differences between the two cases, it would seem appropriate that the Court consider the problem in its variant aspects. Moreover, this case, like *Gilmore*, involves a conflict of decisions.

1. (*a*) The court below reconciles its holding in favor of deductibility with the decision of this Court in *Lykes* v. *United States*, 343 U.S. 118 (denying a deduction for legal fees incurred by a taxpayer in contesting a gift tax deficiency) on the ground that the taxpayer here was not contesting his liability to his wife but was paying his lawyer to find a way in which he could meet his liability without impairing his income-producing property. On this basis, the court concludes that the taxpayer comes within

Section 212(2), which authorizes the deduction of ordinary and necessary expenses incurred in the "management, conservation or maintenance of property held for the production of income." This analysis, we believe, gives insufficient weight to the two principal factors stressed in the *Lykes* decision: *first*, that if the proximate cause of the expenditure is a personal or family matter (a heading which certainly includes a divorce settlement as well as an intra-familial gift), the provision denying the deduction of personal, family or living expenses controls; *second*, that the language and history of Section 23(a)(2) (the predecessor of Section 212(2)) show that it is a provision of narrow compass—one designed to allow deduction of routine management or conservatory expenses which are of an essentially business nature, *e.g.*, the cost of managing personally held securities, albeit they are not incident to the taxpayer's regular trade or business.

Moreover, the decision below is in direct conflict with *Lewis* v. *Commissioner*, 253 F. 2d 821 (C.A. 2d). In attempting to distinguish *Lewis*, the court below erroneously assumed (Appendix, *infra*, p. 18) that all of the legal fees disallowed in that case had been "spent in resisting legal separation proceedings and liability." It appears, however, from the *Lewis* opinion that the husband's legal fees were not incurred in resisting the wife's right to a separation, which he conceded (p. 823), but were attributable principally to resisting her financial demands and to effecting "the adjustment of their respective property rights"

(p. 824). Moreover, the Second Circuit, in *Lewis*, expressly declined (p. 826) to follow *Baer* v. *Commissioner*, 196 F. 2d 646 (C. A. 8th), which had allowed the deduction of legal fees in a divorce case on the theory that they had been incurred by the husband "not to prevent the payment of the liability due Mrs. Baer but to * * * adjust the method of satisfying that liability * * *" (196 F. 2d at 651).[2]

(*b*) Passing the point that the legal expenses incurred by taxpayer arose out of a personal or family matter, we believe that the court below has attempted to draw a line which ignores the realities and will continue to produce confusion. The court treats the expenses as costs incurred in working out the "manner" of separating the property of husband and wife. But the settlement in this case, as in virtually

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[2] The Second Circuit's comment on the *Baer* decision reads as follows (253 F. 2d at 826):

> * * * In Baer the legal expenses sought to be deducted were incurred in connection with an uncontested divorce proceeding in which the sole issue was the form and amount of alimony to be paid to the taxpayer's wife. The property of the taxpayer consisted mainly of stock in a corporation of which he was president and which provided him with the chief source of his income. The financial demands made by the wife were such that the taxpayer would have been unable to meet them without altering his interest in the corporation. The court held that under these circumstances the legal expenses were incurred for "the purpose of conserving and maintaining this income-producing property," 196 F. 2d 646, 651. With all deference, we cannot reconcile this decision with that of the Supreme Court in Lykes v. United States, supra: hence we decline to follow it. * * *

It seems evident from the court's summary of *Baer* that it would no more readily agree with the decision below.

all such cases, determined the content of the settlement—"what" and "how much"—as well as the mode of transfer. So far as the publishing company stock was concerned, the husband did not take his share and the wife hers. An agreement was reached whereby the husband acquired the wife's shares for a price, thus assuring his continuing control of the company. Significantly, an important condition was attached—that the children were to have a remainder interest in all of the husband's shares, both those previously held and those acquired under the settlement purchase. As to the real property involved, the husband completely relinquished his 80 percent undivided interest, placing it in trust for the wife during her life, with the remainder to the children. It seems patent, therefore, that the settlement was not mere property management: it determined rights and liabilities—those of the husband, the wife and the children. In our view, the case sharply illustrates the proposition that the adjustment of intra-familial obligations is typically a matter far removed from the subject matter of Section 212(2), *i.e.*, from the ordinary expense of oversight of income-producing property.[3]

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[3] As indicated above, the legal fees involved here were paid for services in negotiating a settlement agreement under which the taxpayer (1) *acquired* some income-producing property (additional stock in the newspaper publishing business) and (2) *relinquished* his interest in a piece of real property. An expense of acquiring property is a part of the cost of the property and therefore a capital expenditure instead of a deductible expense. And since relinquishing property is the antithesis of conserving property, an expense attributable to its relinquishment cannot qualify (in the absence of a sale or exchange) for a deduction.

2. This case involves a second question (one not involved in *Gilmore*) as to which there is also conflict. The Court of Appeals has ruled that the taxpayer is entitled to deduct, in addition to fees paid his attorney, fees paid to his wife's attorney—this, on the ground that the expenses were "reasonably and proximately related to the management, conservation and maintenance of property held for the production of income" (Appendix, *infra*, p. 16). But since the wife's legal fees were for services to a party whose interest in the husband's property was adverse to the taxpayer's, those fees cannot possibly be deemed a cost of conserving the taxpayer's income-producing property. A similar claim for the wife's legal fees was summarily rejected by the Second Circuit in *Lewis* v. *Commissioner*, citing (253 F. 2d at 828) *Mugruder* v. *Supplee*, 316 U.S. 394, which held that if "X" pays taxes imposed upon "Y" he may not claim the income tax deduction which would have been available to "Y". In allowing a deduction for the wife's attorneys' fees, the decision below is also in conflict with *Baer* v. *Commissioner*, 196 F. 2d 646 (C.A. 8th), which restricted the deduction for legal fees to those paid to the husband's attorney.[1]

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[1] In *Baer*, the husband sought to justify the deduction of the fees he paid to the wife's attorney on the theory that they constituted alimony. The Eighth Circuit disagreed. On this point, see, to similar effect, *Richardson* v. *Commissioner*, 234 F. 2d 248 (C.A. 4th) and *Norton* v. *Commissioner*, 192 F. 2d 989 (C.A. 9th).

In *Owens* v. *Commissioner*, 273 F. 2d 251 (C.A. 5th), cited by the court below, a deduction for legal fees paid by the taxpayer-husband to his wife's attorney was allowed on the ground that the fees were paid for services rendered to the taxpayer. Although that case is distinguishable, we do not concede its correctness.

In separation or divorce proceedings, the husband commonly assumes the duty to pay the wife's legal fees or is required to do so by decree of court. Thus, this branch of the decision below also involves a question which is bound to recur with some frequency.

CONCLUSION

For the reasons stated above and in the petition filed in the companion *Gilmore* case, this petition for a writ of certiorari should be granted.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

MELVA M. GRANEY,
HAROLD C. WILKENFELD,
Attorneys.

JULY 1961.

APPENDIX

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 8259

TALBOT PATRICK AND COMMERCIAL BANK OF CHARLOTTE, ADMINISTRATOR OF THE ESTATE OF ALETHIA M. PATRICK, DECEASED, APPELLEES

v.

UNITED STATES OF AMERICA, APPELLANT

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF SOUTH CAROLINA, AT ROCK HILL. C. C. WYCHE, DISTRICT JUDGE

(Argued January 25, 1961. Decided March 27, 1961.)

Before SOPER, and HAYNSWORTH, Circuit Judges, and LEWIS, District Judge.

LEWIS, *District Judge*:

This is an action to recover income taxes paid under a deficiency assessment arising from the disallowance of a deduction for legal fees paid to taxpayer's and his former wife's attorneys for services rendered in connection with a property settlement incident to a divorce of the parties.

The District Court for the Western District of South Carolina, hearing the case without a jury,

sustained the contentions of the taxpayer, 186 F. Supp. 48, and the Government appealed.[1]

We adopt the findings of fact by the District Court which are substantially as follows:

The taxpayer was sued for divorce. The wife sought an absolute divorce, court supervision of the properties, a property settlement, child custody and attorney fees. The taxpayer neither admitted nor denied the alleged grounds for divorce. He did not testify at the trial. Extended negotiations were carried on by attorneys for both parties, culminating in a property settlement. The trial court in South Carolina granted the wife an absolute divorce, approved the property settlement and ordered the taxpayer to pay all attorney fees for both parties, provision for which had also been previously agreed upon.

At the time of the institution of the divorce proceedings and for some years prior thereto the taxpayer was the operating head of the Herald Publishing Corporation. He owned 28% of the stock and his wife owned 28%. The eldest son owned 9% and the balance thereof was held in trust for the use and benefit of the children. The only other income-producing property was real estate (a building mainly occupied by the publishing corporation). The taxpayer had an 80% undivided interest therein and the wife had a 20% undivided interest.

The pertinent portion of the settlement agreement provided the taxpayer would purchase the wife's 28% interest in the publishing corporation stock at fair market price, conditioned upon the further agreement that the stock acquired from the wife, together with the taxpayer's stock in the publishing corpora-

[1] The Government did not appeal the constructive dividend issue decided in favor of the taxpayer.

tion (56%) would pass to the children on his death, or if the stock was sold prior thereto, the proceeds would become the property of the children. The undivided interests of the taxpayer and his wife in the income-producing real estate were placed in trust for the children, subject to a lease to the publishing corporation for a term of years.

The attorney fees incurred by the parties for the divorce action and settlement agreement were $12,000.00 each, or a total of $24,000.00, $4,000.00 of which was for handling of the divorce, $4,000.00 for placing the real estate in trust ($3,200.00 of which was charged to the taxpayer and $800.00 to the wife), and $16,000.00 for the rearranging of stock ownership and control of the Herald Publishing Corporation. Prior to the institution of the divorce proceedings the taxpayer, because of family unity, controlled the publishing corporation and was editor and publisher of the newspaper and drew salaries therefrom.

During the pendency of the divorce proceeding there was more than a possibility the control of the publishing corporation would be sold and that the income-producing real estate might be partitioned and/or sold. Prospective purchasers of the publishing corporation were interviewed by the wife's attorneys. The wife made no immediate threat upon taxpayer's operation or control of the newspaper and did not seek to enjoin or encumber his interest therein. The eldest son appeared to favor the mother in the marital difficulties and the wife and children were very much opposed to the apparent remarriage of the taxpayer.

The taxpayer contends that that portion of the attorney fees paid for legal services rendered solely in connection with the property settlement was deduct-

ible pursuant to Title 26, United States Code, Section 212(2) (1954 ed.).[2]

The District Court found the legal fees in the amount of $3,200.00 and $16,000.00 were reasonably and proximately related to the management, conservation, or maintenance of property held for the production of income and were therefore an allowable deduction to the taxpayer. We agree.

The Government insists however, that legal fees paid in connection with a divorce proceeding, accompanied by a property settlement, are incurred in relation to the dissolution of a personal family relationship, and that Title 26, United States Code, Section 262 (1958 ed.)[3] specifically denies a taxpayer a deduction with respect to a personal or family expense. Such is correct, in those cases where the expenses incurred were paid for legal services in representing the parties in a divorce proceeding, or in contesting the liability accruing as a result thereof. In this case $4,000.00 in legal fees were incurred in the handling of the divorce proceeding. No deduction or claim therefor was made. The taxpayer incurred additional legal fees in the amount of $3,200.00 for services rendered in connection with the preparation of the trust agreement and the leasing of the income-producing real estate, of which he owned a 4/5th undivided interest, and $16,000.00 in additional legal

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[2] "Expenses for production of income. In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(2) for the management, conservation, or maintenance of property held for the production of income;"

[3] "Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses."

fees for the rearranging of the stock ownership and control of the Herald Publishing Corporation.

The Government does not deny the reasonableness of the fees or the necessity therefor. It contends: "When the distinction between immediate purpose and incidental consequence is given effect, attorneys' fees paid in relation to a property settlement under a divorce decree are necessarily nondeductible as being personal expenses, regardless of whether there is an effort by one spouse to maintain and conserve income-producing property". With this we do not agree.

The Eighth, Sixth and Fifth Circuits and Court of Claims[*] have all reached the opposite result in regard to this question. An examination of those cases indicates the legal fees were allowed as a deduction because they were not expensed to resist a liability, but were spent to find a manner in which it could be met without depriving taxpayer of his income or income-producing property.

In the Baer case the Court stated:

> "* * *. The controversy did not go to the question of the liability but to the manner in which it might be met by the petitioner without greatly disturbing his financial structure. * * *"

In the Bowers case the Court allowed a $45,000.00 attorney fee as claimed, with the statement that, as in the Baer case, "* * * there was little occasion for the services of a taxpayer's lawyers, in divorce proceedings proper, * * * such services were largely

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[*] Baer v. Commissioner, 196 F. 2d 616 (8th Cir.); Bowers v. Commissioner, 243 F. 2d 904 (6th Cir.); Owens v. Commissioner, 273 F. 2d 251 (5th Cir.); McMurtry v. United States, 132 F. Supp. 113 (Court of Claims).

devoted to adjusting the taxpayer's liability to his wife * * *."

In the Owens case the Court stated:

> "* * *. The ultimate and only fact before the Tax Court and before us was and is whether the $7,500 was actually paid to the attorney in connection with the saving of the business in which the husband was interested. * * *. In other words, the domestic dispute furnished the occasion, but not the motive, for the payment of the $7,500 to the attorney."

In the McMurtry case the Court of Claims gave the taxpayer an opportunity to show to what extent legal expenses were incurred in conservation and maintenance of property.

The Government relies mainly upon Lykes v. United States, 343 U.S. 118, and Lewis v. Commissioner, 253 F. 2d 821. Neither of these cases are in conflict with the above cited cases. In the Lykes case deductibility turned wholly upon the activities to which they were related. The taxpayer gave away stock with a fixed value and the Commissioner of Internal Revenue revalued it and assessed a deficiency. The fees were incurred in contesting this deficiency or in resisting liability.

In the Lewis case the Second Circuit refused to allow a deduction of attorney fees on the theory that such fees were spent in resisting legal separation proceedings and liability.

The other cases relied on by the Government in support of its theory are clearly distinguishable in that the facts therein recited are not analogous to the facts in this case.[5]

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[5] Harris v. United States, 275 F. 2d 238; Tressler v. Commissioner, 228 F. 2d 356; Howard v. Commissioner, 202 F. 2d 28; Smith's Estate v. Commissioner, 208 F. 2d 349; Norton

Richardson v. Commissioner, 234 F. 2d 248 (4th Cir.), likewise does not support the Government's position. In that case this Court stated:

> "* * *. It is clear that the attorneys for the husband expended no effort in the conservation or maintenance of his property, as envisioned by the statute. * * *. Their services were directed to preventing any liability being imposed upon the husband for his wife's support, and it is this for which they were paid. * * * even if any part of the fee paid by him to his attorneys could be said to be for services in conserving his property, no effort has been made to show what part of the sums paid should be allotted to that purpose. * * * unless and until it is shown what part of the sums paid them are applicable to that part of their efforts there is no basis upon which to grant a deduction.
>
> "* * *. None of the conditions which formed the basis for the decision in the Baer case exists in the case now before us."

The Government further contends however that if this case were pending in a Circuit that had followed the reasoning set forth in the Baer line of decisions, the taxpayer's claim of deduction would not be allowed because the essential factor in the application of those decisions was a threat to income-producing property.

It is true the wife, in this case, did not commit an overt act, to either enjoin, damage or encumber the taxpayer's income-producing property. This was not necessary. We conclude that all of the taxpayer's income-producing properties were in great peril until and unless a satisfactory property settlement agreement was concluded.

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v. Commissioner, 192 F. 2d 960; Douglas v. Commissioner, 33 T.C. 349; Donnelley v. Commissioner, 16 T.C. 1196;

At the time he was sued for divorce the taxpayer was a stockholder in Herald Publishing Corporation. He owned 28%, his wife 28%, their son Hugh 9%, with 7% additional in trust, and two other children owned 28% of the stock in trust. Because of the family unity which had existed, taxpayer had in fact controlled the Herald operations and had been editor and publisher of the newspaper and a director and president of the corporation and drew salaries therefrom. When the divorce suit was commenced against him practically everything he had was at stake. There was the distinct possibility that control of the corporation would be sold; in fact, the wife's attorneys were approached by prospective purchasers. It was not necessary for his wife to threaten to take from him the Herald stock. The wife, with her own stock and as a trustee jointly controlling the stock of her children, with the support of her son Hugh, controlled the corporation. With the family unity broken, this control could have been, and probably would have been, exercised by the wife to the taxpayer's detriment.

Over a period of years he had built up the newspaper and if he lost control his income therefrom would not only have been impaired, it would have been totally destroyed. In addition, upon the entry of a divorce decree the wife acquired the right to partition and/or force the sale of the income-producing real estate which housed the publishing corporation, thereby jeopardizing its very existence.

The husband had no defense to the merits of the divorce. He did not contest or resist the liabilities accruing to the wife and children and the legal fees claimed as a deduction were not expended for that purpose. They were spent by the taxpayer for services rendered through long and continued negotiations,

designed to find a means in which the taxpayer could meet these liabilities without destroying his income and his income-producing status.

The fact that the agreement between the parties was concluded in apparent harmony and without any overt act on the part of the wife to take away, or threaten to take away, the income-producing property of the taxpayer, does not say that there was no risk to the taxpayer. The danger to his income and income-producing property was there until the matter was concluded, and it was not concluded until there was a readjustment of his income-producing holdings.

The Government further contends, however, that even though the legal fees incurred by the taxpayer in maintaining and conserving his income-producing property are deductible under Code Section 212(2), the fees paid his wife's attorneys are under no circumstances deductible. The taxpayer's liability for his legal fees and the legal fees for his wife would not have been incurred except for the necessity of the long and extended negotiations culminating in the preservation, maintenance and conservation of the taxpayer's income-producing property. They were incurred for that purpose and that purpose only.

The only test of deductibility provided for in the statute is whether or not the expenses were reasonable and proximately related to the management, conservation and maintenance of income-producing property. It makes no difference to whom they are paid.

In the Lykes case, supra, the Supreme Court stated:

> "* * * deductibility turns wholly upon the nature of the activities to which they relate. * * *."

And in the Owens case, supra, the Court said:

> "We do not think that the fact that the payment here was made to the wife's attorney has any determinant force. * * *."

In view of the findings of fact of the District Court and the undisputed testimony in behalf of the petitioner we are of the view, the legal fees in the amount of $19,200.00, which were paid by the taxpayer for the protection and conservation of his income-producing property was properly deductible as claimed. The decision of the District Court is accordingly

Affirmed.

JUDGMENT

Filed and Entered March 27, 1961

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 8259

TALBOT PATRICK AND COMMERCIAL BANK OF CHARLOTTE, ADMINISTRATOR OF THE ESTATE OF ALETHIA M. PATRICK, DECEASED, APPELLEES

vs.

UNITED STATES OF AMERICA, APPELLANT

APPEAL FROM the United States District Court for the Western District of South Carolina.

THIS CAUSE came on to be heard on the record from the United States District Court for the Western District of South Carolina, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

March 27, 1964.

MORRIS A. SOPER,
United States Circuit Judge.

No. 286

Supreme Court of the United States

OCTOBER TERM, 1961

UNITED STATES, PETITIONER,

versus

TALBOT PATRICK, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR TALBOT PATRICK, ET AL.

ROBERT M. WARD,
Andrew Jackson Hotel Bldg.,
Rock Hill, South Carolina.

The R. L. Bryan Company, Legal Printers, Columbia, S. C.

INDEX

CITATIONS

No. 256

Supreme Court of the United States

OCTOBER TERM, 1961

UNITED STATES, PETITIONER,

versus

TALBOT PATRICK, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR TALBOT PATRICK, ET AL.

QUESTIONS PRESENTED

1. Whether the portion of a taxpayer-husband's legal expenses, allocable to the property settlement aspect of a divorce proceeding, are deductible, for income tax purposes, on the theory that they are "ordinary and necessary expenses paid * * * for the management, conservation, or maintenance of property held for the production of income," within the meaning of Section 212 (2) of the Internal Revenue Code of 1954.

2. Whether the taxpayer-husband, having been ordered by the state court to pay, and having paid, legal fees owed by the wife to her attorney for similar services, may deduct those fees under Section 212 (2) of the 1954 Code.

STATEMENT

Taxpayer does not accept the statement of the case by the United States as it is not a fair statement and contains, at least one gross error significant to a portion of the Petitioner's argument.

Talbot Patrick, the taxpayer, was sued for divorce by his then wife, Paula M. Patrick, on December 16, 1955, in the Court of Common Pleas for York County, South Carolina. The wife sought an absolute divorce on grounds of adultery, court supervision of division of the properties, a property settlement, child custody, and attorneys fees. Taxpayer neither admitted nor denied the allegations of adultery and did not offer testimony at the divorce hearing. The Court subsequently issued a final decree of absolute divorce, approved the property settlements made by the parties in an "Amended Stipulation and Agreement", and, by reference, required the payment by taxpayer of all attorney fees. (P.R. 7, 46-47.)[1]

The "Amended Stipulation and Agreement" was the result of extended negotiations between counsel for both parties. It provided for payments by the taxpayer for the support and maintenance of the parties' children (P. R. 9-11) and contained provisions relating to specific properties. The taxpayer and his wife were each to receive one of the two family residences. (P. R. 8) Income producing properties then were considered. Taxpayer purchased at fair market value, the rights to income from and voting control of his wife's 28% of stock in Herald Publishing Company under a provision that he could not sell the stock unless it was part of a sale of the whole of the company's stock and that then the stock must first be transferred to his children who would affect the sale and receive the proceeds. In the event of his prior death the stock would pass

[1] References to the record in *United States v. Patrick*, No. 256, are prefixed "P. R."

to his children. (P. R. 5, 11-12.) Taxpayer's 80% interest in real property leased in part to the publishing company was placed in trust with the net income to the wife for life and then to the children; with the trust to terminate when the youngest child reached the age of 21 years, at which time the property would be conveyed to the children. (P. R. 5, 8-10.) A part of the agreement provided continued use of the property by the publishing company under a lease for ten years (with options for renewal).

Taxpayer, who was editor and publisher of the company's newspaper, was a minority stockholder in the corporation, the majority of the stock being in the wife (28%) and in trusts for the children (35%) and in a son (9%). (P. R. 4.)

The attorneys' fees incurred by each party were $12,000.00, a total of $24,000.00. Pursuant to the divorce decree the taxpayer paid these fees. Fees were allocated by counsel and the parties as follows: $4,000.00 for the handling of the divorce, $4,000.00 for the handling of the real estate ($3,200.00 charged to taxpayer and $800.00 to his wife in proportion to prior 80% and 20% interests), and $16,000.00 for negotiation and rearrangement of the stock holdings.

Taxpayer claimed deductions for the $16,000.00 paid for legal services in connection with the stock and $3,200.00 for services in connection with the real estate. He did not claim any part of the $4,000.00 paid for legal services connected with the divorce. (P. R. 46-52.)

The District Court found that the $3,200.00 and the $16,000.00 paid by Talbot Patrick as attorneys fees were deductible as expenses incurred for the management, conservation or maintenance of property held for the production of income. The Court of Appeals affirmed, saying that in view of the findings of fact of the District Court and the undisputed testimony in behalf of the petitioner, the legal

fees in the amount of $19,200.00 which were paid by taxpayer for the protection and conservation of his income-producing property was properly deductible as claimed.

SUMMARY OF ARGUMENT

I

Legal expenses which are reasonably and proximately related to the management, conservation, or maintenance of property held for income are deductible for income tax purposes. In this case the trier of the facts, the District Court sitting without a jury, determined as a matter of fact that the expenses in question were reasonably and proximately related to the management, conservation, or maintenance of income-producing property. The fees paid in connection with the dissolution of the marriage relationship were properly considered by the taxpayer to be personal, and these were not claimed. But fees expended by a minority stockholder to retain threatened control of a business which he had held by sufference only and to be able to continue the uninterrupted use of a business leasehold when he had divested himself of any ownership of the property cannot be considered personal. The government seeks too broad a rule: It may be true that fees incident to a divorce may in some cases not be deductible as personal expenditures too remote from income or income-producing property. But under the decided facts in this case the fees were properly deductible.

And the fees were no part of the capital cost of acquisition of property since taxpayer paid market value for stock but gained only the limited control and use of the stock. The fees were involved in the lengthy negotiations necessary to find an acceptable means of rearranging property holdings.

II

If attorneys fees are in truth deductible, they are deductible to the person who pays them under a legal duty to do so regardless to whom they are paid. Since the divorce fees themselves were separated and not claimed, the fees claimed as deductible were all expended for the same purpose and in much the same manner as if there had been involved the dissolution of a business partnership.

ARGUMENT

I

Since 1942 there has been provision in the Internal Revenue Code for deduction of some nonbusiness expenses. This was the Congress' solution to the problem of lack of such legislation as emphasized by the case of *Higgins v. Commissioner*, 312 U. S. 212. An examination of the statute and the decided cases makes clear that whether or not an expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable. This does not apply to expenses primarily involved in sports, hobbies, or recreation, but does apply when such expenses are ordinary and necessary, reasonable in amount, and bear some reasonable and proximate relation to the production or collection of income or to the management, conservation, or maintenance of property held for that purpose. Thus on a showing that in this case the attorneys' fees taxpayer was required to pay met these tests, the District Court properly held them deductible. In this case the United States has not questioned that the fees were ordinary and necessary expenses and reasonable in amount. The issue grows out of the activity to which the fees were related.

A. The trier of fact has determined that attorneys fees here involved bore a reasonable and proximate relation to the management, conservation, or maintenance of property held for income.

In this case the District Court, sitting without a jury, heard all the facts and circumstances and determined that the attorneys fees were expended by taxpayer in the management, conservation, or maintenance of income-producing property.

In *Trust of Bingham v. Commissioner*, 325 U. S. 365, the Tax Court had heard the facts and concluded that legal fees were expended for the management and conservation of income-producing property. The Second Circuit reversed, 145 F. (2d) 568. The Supreme Court granted certiorari; and, in reversing the Second Circuit and affirming the findings of the Tax Court, said:

> "* * * Deductible expenses * * * must be reasonable in amount and must bear a reasonable and proximate relation to the management of property held for the production of income. * * * Ordinarily, questions of reasonableness and proximity are for the trier of fact, here the Tax Court. *Commissioner v. Heininger*, 320 U. S. 467, *McDonald v. Commissioner*, 323 U. S. 57, 64-65, *Commissioner v. Scottish American Investment Co.*, 323 U. S. 119. * * * The Tax Court could find as a matter of fact, as it did, that the expenses of contesting the income taxes were a proximate result of the holding of the property for income. And we cannot say, as a matter of law, that such expenses of suits to recover income."

B. Attorneys fees reasonably and proximately related to the management, conservation, or maintenance of property held for the production of income are not personal, living, or family expenses, but are nonbusiness expenses properly deductible under Code Section 212 (2).

In *Lykes v. United States*, 343 F. S. 118, the Court reviewed the whole question of nonbusiness deductions. It cited in particular the House Committee Report:

> "* * * Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable * * *. The expenses, however, of carrying on a transaction * * * primarily as a sport, hobby, or recreation, are not allowable as non-trade or non-business expenses. Expenses to be deductible * * * must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income or to the management, conservation, or maintenance of property held for that purpose * * *." H. R. Rep.

2333, 77th Congress, 2nd Session. To the same effect see S. Rep. No. 1631, 77th Congress, 2nd Session.

In *Lykes*, the ordinary and necessary character of the legal expenses incurred was recognized. Deductibility turned wholly upon the nature of the activities to which they related. And so, as taxpayer sees it, does this case.

Lykes considered a gift tax question. The taxpayer gave away stock with a fixed value and the Commissioner of Internal Revenue revalued it and assessed a deficiency. The fees in that case were incurred in contesting this deficiency or in resisting liability, not as in the instant case, in seeking and finding a legal and acceptable manner for rearranging holdings of income-producing property to meet a liability and still conserve income and income-producing property.

"Legal expenses", said *Lykes*, "do not become deductible merely because they are paid for services which relieve a taxpayer of liability * * *. (The) Section never has been so interpreted by us. It has been applied to expenses on the

basis of their immediate purposes rather than upon the basis of the remote contributions they might make to the conservation of a taxpayer's income-producing assets by reducing his general liabilities." *McDonald v. Commissioner*, 323 U. S. 57, 61-63.

In *Lukes* the taxpayer was resisting a deficiency tax assessment and seeking to reduce a cash liability. The Court was faced with these facts and also with Treasury Decision 5513, 23 CFR 29.23 (a)-15 (k) in force since 1946 (to which it gave weight) unequivocally holding that fees in determining gift tax liability are not deductible.

In *Baer v. Commissioner*, 196 F. (2d) 646, the Eighth Circuit Court of Appeals held that "* * * the controversy did not go to the question of liability but to the manner in which it might be met by the petitioner without greatly disturbing his financial structure * * *" The Court allowed $16,500.00 of the husband's attorneys fees as being involved in the maintenance or conservation of property for the production of income.

Fees similarly were allowed on this basis in *Fisher v. United States*, 157 Fed. Supp. 364, and *Aller v. United States*, 56-2 USTC 9867.

In *Bowers v. Commissioner*, 243 F. (2d) 904 (6th C. A.) the Court allowed a $45,000.00 attorneys fees as claimed, with the statement that as in the *Baer case* there was little occasion for lawyer's services in the divorce, that their services were largely devoted to adjustment of the taxpayer's liability to his wife.

In *McMurtry v. United States*, 132 Fed. Supp. 414, the Court of Claims cited *Baer* and gave taxpayer an opportunity to show to what extent legal expenses were incurred in conservation and maintenance of property.

In certain cases attorneys fees have been denied. But they are easily distinguished from the instant case.

In *Harris v. United States*, 275 F. (2d) 238, the Ninth Circuit held that attorneys' fees were incurred to resist the wife's claim that there was community property and there was no evidence of the value of the attorneys' fees in dividing property. This case, the Court said, was not *Bacr*.

In *Tressler v. Commissioner*, 228 F. (2d) 356, the Ninth Circuit cited *Bacr* and *McMurtry* but distinguished *Tressler* by saying that the expense of the litigation was incurred to defeat the wife's suit and not to protect the petitioner's property.

In *Howard v. Commissioner*, 202 F. (2d) 28, the Ninth Circuit cites *Bacr* with approval but says that Howard's fees involved the defense of the wife's action to collect money awarded her in a divorce action and therefore were not deductible. *Smith's Estate v. Commissioner*, 208 F. (2d) 349, and *Norton v. Commissioner*, 192 F. (2d) 960, can be similary distinguished.

In refusing to permit deductions, the Fourth Circuit has said in *Richardson v. Commissioner*, 234 F. (2d) 248, that "* * * It is clear that the attorneys for the husband expended no effort in the conservation or maintenance of his property as envisioned by the statute * * * Their services were directed to preventing any liability being imposed upon the husband for the wife's support and it is this for which they were paid. * * * Even if any part of the fee paid by him to his attorneys could be said to be for services in conserving his property, no effort has been made to show what part of the sums paid should be alloted to that purpose * * * Unless and until it is shown what part of the sums paid them are applicable to that part of their efforts there is no basis upon which to grant a deduction * * * None of the conditions which formed the basis for the decision in the *Bacr* case exists in the case now before us."

In *Douglas v. Commissioner*, 33 T. C. 349, the wife was attempting to deduct legal fees incurred in an attempt to secure property in connection with a marital separation.

Donnelley v. Commissioner, 16 T. C. 1196, disallowed deduction of legal expenses paid in resisting a former wife's suit to collect back alimony. This case was decided before the *Baer case*.

In *Lewis v. Commissioner*, 253 F. (2d) 821, the Second Circuit refused to allow attorneys fees on the theory that such fees were spent in resisting legal separation proceedings and liability. The case was in no way similar to the instant case.

Judge Waterman did write in *Lewis, supra*, that he could not reconcile *Baer* with *Lukes*; but Judge Lumbard "would limit this discussion to distinguishing *Baer v. Commissioner* on its facts" and he would have allowed expenses in litigation over revocation of an *inter vivos* trust.

All decisions read with the statute and *Lukes* in mind simply bear out that not all attorneys fees are deductible but equally that in certain circumstances they are. A broad rule such as is sought here would bar relief in proper cases such as the instant one.

The courts have allowed deduction of attorneys fees in property settlements growing out of divorces where there is a reasonable and proximate relation to production of income or conservation or management of income property.

> An essential in this case, as in the *Baer* line of decisions and as outlined in the *Lukes case*, was that the fees were not expended to resist liability but to find a manner in which it could be met without depriving taxpayer of his income or income-producing property.

Consideration should be given to the question as to whether or not a "treat" to property is the real test in the *Baer* line of cases. It is true that a "threat" appears, but that was

the occasion for the expenditures of fees rather than the justification therefor under the law.

In any event, there was a "threat" to both the income and the income producing property of taxpayer in this case. (P. R. 31.)

At the time he was sued for divorce, taxpayer was a minority stockholder in *Herald Publishing Co.* He owned 28%, his wife 28%, a son Hugh 9%, with 7% additional in trust, and two other children owned 28% of the stock in trust. Because of the family unity which had existed, taxpayer had controlled the Herald operations and had been Editor and Publisher of the newspaper and a director and president of the corporation and drew salaries therefrom. With the commencement of the suit against him, practically everything he had was at risk. There was the distinct possibility that control of the corporation would be sold, and the wife's attorneys were approached by prospective purchasers.

It was not necessary for his wife to take from him his Herald stock for taxpayer to be subject to the loss of his salaried position and his only salary income as well as control of the operations to which he had given years of effort and which he had built up. His wife, with her 28% of the stock and as trustee jointly controlling the stock of her children and with the support of her son Hugh's, could have controlled the corporation. With family unity broken, this control could have been exercised by the wife to taxpayer's detriment.

It developed in the negotiations, however, that there was a way to meet taxpayer's liabilities to his wife.

He did not resist these liabilities, and attorneys fees were not expended for that purpose.

The negotiations concerned themselves with the manner in which taxpayer could meet these liabilities without

destroying his income and income property status. These were the immediate purposes of the expenditure of the fees. The United States argues that the agreement between the parties as to the manner of solution shows full accord and harmony between the parties and no risk to taxpayer. In so arguing, Petitioner is ignoring a fact of life; that months of patient negotiation by competent and experienced counsel concerned with the best interests of their clients was necessary to effect the agreement.

The risk and danger to income and income producing property was there until the matter was concluded. And it was not concluded until there was a readjustment of income-producing holdings under which the taxpayer gave up his undivided interest in the building occupied by the newspaper and thus assured that there would be no partition of this real estate or outside co-owner and no interruption of occupancy of the building, conserving also its income-producing potential for the children of taxpayer and his wife. Prior to this agreement, the wife had equal rights to control or block control of the use of this business real estate. (R. 32, 33.)

The matter was not concluded until taxpayer had transferred some $112,000.00 in high quality income-producing stocks and bonds in exchange for what amounted to a voting right for life in the wife's stock in the newspaper corporation. The manner of meeting taxpayer's liability in this particular was important in preserving his financial structure. It is implied that there was no overt move to claim taxpayer's stock and that anything else of value would have satisfied the wife's claim and that stocks and bonds did in fact satisfy this claim without disturbing taxpayer's Herald stock. But Mr. Spencer testified that he was convinced that Mrs. Patrick had a definite and special interest in the Herald Publishing Co. stock as such, for-

reasons shown, and would not in any sense have considered some other blue chip stock of equal monetary value to be acceptable by way of direct exchange with no limitations. (P. R. 37.)

So, for all purposes, Patrick was in the position of *Bacr*. To try to define degrees of threat or to be guided by total sums of money involved would lead the Court too far astray from what seems to be a sound construction of the basic statute in the light of the legislative intent.

Examination also reflects that an essential element outlined in *Lakes* and considered in *Bacr* and related cases is that the controversy did not go to the question of liability but to the manner in which it might be met without disturbing taxpayer's financial structure.

C. Attorneys fees were not the cost of acquiring stock or disposing of real estate but were reasonably and proximately related to management, conservation, and maintenance of income-producing property.

Fees were expended, as argued above, for the negotiations which produced a settlement determining a manner for meeting the wife's claims without disrupting taxpayer's ability to earn. (P. R. 40, 41.)

Taxpayer's salary, as he testified (Tr. 38), was low because of his interest in the newspaper and the building of a good property. It was necessary to his continued income and protection of the value of his income-producing stock that he continue his control. So, the shifting of other income-producing property for that which would assure him a voting control of the corporation and continuance of his positions with the corporation was necessary. These were incidents of management and conservation of his income-producing property; and this was a part of the expense incurred by him. And his income situation was changed by the settlement, so that the newspaper position and prop-

erty became more important in his total financial situation. He paid from income producing property the fair market value of his wife's stock, but obtained only control, the stock to pass to his children prior to any sale or to them at his death. And he lost the income from rental of the business property which had made up a part of his total income.

His placing of his undivided interest in the business real estate in trust along with the undivided interest therein of his wife was an incident of the management and conservation of his income-producing property through protection against division and through assurance of an undisturbed lease for the newspaper. And this, too, was the result of negotiations by counsel for which the fees were paid.

II

Legal fees which taxpayer was required to pay his wife's attorneys were deductible exactly as were those he paid his own attorneys.

Attorneys fees were demanded in the divorce action and required to be paid by taxpayer under the Court's final Order. So far as they related to the divorce itself and the essentials thereof $2,000.00 to his own and $2,000.00 to his wife's attorneys) they were paid by taxpayer and not claimed as deductible. But $19,200.00 in fees paid jointly to the attorneys for taxpayer and his wife and attributed to the long negotiations of and rearrangement of the stock and business property were paid and are claimed as deductible. If the fees were in truth deductible because of the activities to which they related, as argued herein, they were deductible to taxpayer no matter to whom the taxpayer paid them.

In *Owens' v. Commissioner*, 273 F. (2d) 251, the Fifth Circuit permitted deduction of fees paid to the wife's attorney in a property settlement incident to a divorce. The

Court set out, as is argued here, that "* * * deductibility turns wholly upon the nature of the activities to which they related * * * We do not think that the fact that the payment was made to the wife's attorney has any determinant force * * * The ultimate and only fact before the Tax Court and before us was and is whether the $7,500.00 was actually paid to the attorney in connection with the saving of the business in which the husband was interested * * *. In other words, the domestic dispute furnished the occasion, but not the motive, for the payment of the $7,500.00 to the attorney."

From the Patrick record it appears that much of the negotiations of attorneys in connection with the property settlement was designed to arrive at a means of permitting taxpayer to retain his control of the newspaper and his offices and employment but to "tie up" and limit his interests in a manner acceptable to his wife. And in this area it appears that there were "almost joint aims" of opposing counsel (although certainly within every bound of propriety).

John H. Lumpkin, counsel for the wife, testified that "I am trying to recollect as precisely as possible, which is the reason for my pause, the background and the reasons for the final stipulation. Certainly in part it was as stated by you, to tie up his interest thereby protecting the children. Certainly in part it was to continue him in active management of the newspaper and to provide that if he should dispose of could dispose of his interest, the children would be protected, and finally I think a very cogent reason in these negotiations as culminated in the Stipulation was to continue him in an income producing status."

He was asked: "Mr. Lumpkin, are you speaking of the negotiations as a whole, or the aims which you were striving for as Mrs. Patrick's attorney?" and he replied:

"I might say these are almost joint aims as between Mr. Spencer as attorney for the Defendant and by me as Attorney for the Plaintiff."

It is true the Eighth Circuit did not allow the wife's attorneys fees in *Baer*. But in *Baer* it was argued that $35,000.00 for purchase of a home and $20,000.00 attorneys fees were "periodic payments" to the wife when all the evidence showed this as a lump sum part of a divorce settlement. There was no claim or inding of fact that the fees were related to the conservation of income producing property. The present (*Patrick*) case makes no attempt to deduct the elements of the settlement on taxpayer's wife nor does it claim that the attorneys fees were part of "periodic payments" to her. It poses the question as coming within the thinking of the *Lykes case*: that the fees were reasonably and proximately related to the management, conservation and maintenance of income producing property.

In *Norton*, *Richardson*, and *Lewis*, all examined herein above, the wife's attorneys fees were not allowed; but the question here posed was not answered there since none of the fees were allowed. It would follow that if the attorneys fees, because of the activities to which they related, were not deductible as to the husband's attorneys, they would not be deductible by him as to the wife's attorneys.

The only test under the Statute is that the fees be expended in a transaction reasonably and proximately related to the production or collection of income or the conservation, management, or maintenance of income-producing property. If they were so expended, then they are deductible no matter to whom they were paid.

CONCLUSION

The judgment of the Courts below should be affirmed.

Respectfully submitted.

ROBERT M. WARD,
Post Office Box 1071,
Rock Hill, South Carolina,
Counsel for
Talbot Patrick, et al.

Rock Hill, South Carolina,
February, 1962.

No. 22

Supreme Court of the United States

OCTOBER TERM, 1962

UNITED STATES, PETITIONER,

versus

TALBOT PATRICK, *ET AL.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR TALBOT PATRICK, ET AL. ON REARGUMENT *

ROBERT M. WARD,
Andrew Jackson Hotel Bldg.,
Rock Hill, South Carolina.

* This brief replaces the original brief on the merits filed by Robert M. Ward.

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CITATIONS

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QUESTIONS PRESENTED

1. Whether the issues in this case have been determined by the District Court and affirmed by the Court of Appeals as questions of fact.

2. Whether under the facts in this case taxpayer is entitled to a deduction under Section 212 (2) of the Internal Revenue Code of 1954 for legal fees he paid his own and his former wife's attorneys for legal services rendered in connection with negotiation for and transfer and exchange of income-producing properties.

This brief replaces the original brief on the merits filed by Robert M. Ward.

STATEMENT

Talbot Patrick, the taxpayer, was sued for divorce by his then wife, Mrs. Paula M. Patrick, on December 16, 1955, in the Court of Common Pleas for York County, South Carolina. The wife sought an absolute divorce on grounds of adultery, court supervision of division of properties, a property settlement, child custody, and attorneys fees. Taxpayer's time to answer was extended. There then followed extended negotiations between counsel for the parties, the most difficult and time-consuming portion being given to reaching agreement on certain business properties (R. 31, 42-43) which had a unique value to both parties. (R. 24, 35, 43.) As a result of these negotiations, a Stipulation and Agreement was entered into April 17, 1956. This was superceded by an Amended Stipulation and Agreement of June 14, 1956. (R. 17-15.) The agreement provided for custody of children, payments by taxpayer for support and maintenance of the children, and for taxpayer and his wife each to take one of the two family residences. It also provided for transfer and exchange of income-producing properties of the parties, as hereinafter shown. Taxpayer did not contest the divorce and did not testify at the hearing. The Court subsequently issued a final decree of absolute divorce, approved the property settlements and exchanges made by the parties, and, by reference, required the payment by taxpayer of all attorneys' fees. Counsel for the parties charged fees of $2,000.00 each, or a total of $4,000.00, for handling the divorce and matters incidental thereto. Taxpayer paid the total fee; and no part of this $4,000.00 was claimed as deductible by taxpayer.

Taxpayer was at the time of the divorce action President and Treasurer of the Herald Publishing Co., and editor and publisher of the company's daily newspaper at Rock Hill, South Carolina. He owned 28% of the stock

of the publishing company, the majority of the stock being in his wife (28%), in a son (9%) and in trust for the children (35%). As a result of the negotiations of counsel, taxpayer was able to transfer $112,000.00 in "blue chip" securities to his wife in exchange for her 28% stock. (R. 11.) The $112,000.00 was the fair market value for the stock as determined by offers of purchase at the time. (R. 24.) Taxpayer took the stock subject to a condition that he could not sell it unless such sale was part of a sale of the whole of the company's stock and that in such event he must first transfer the stock to his children who would effect the sale and receive the proceeds. In the event of his death prior to any such sale the stock would pass to his children. For the negotiations which made possible this transfer of properties, and for implementing same, counsel for the parties charged total fees of $16,000.00, which taxpayer paid and claimed as deductible.

Real property leased in part to the publishing company was owned at the time of the divorce by taxpayer (80%) and his wife (20%). As a result of the negotiated agreement, these interests were transferred to a trust with the net income to the wife for life and then to the children. A long term lease to the publishing company was guaranteed by the agreement. The total fees of counsel were $4,000.00, which taxpayer paid. Since his interest in the real property had been 80%, he claimed 80% of the fees, or $3,200.00, as deductible.

The District Court found that the $16,000.00 and the $3,200.00 paid by Talbot Patrick as attorneys fees were deductible as expenses incurred for the management, conservation or maintenance of property held for the production of income. The Court of Appeals affirmed, saying that, in view of the findings of fact of the District Court and the undisputed testimony on behalf of the petitioner (tax-

lawyer the legal fees in the amount of $19,200.00 paid by taxpayer for the protection and conservation of his income producing property were properly deductible as claimed.

ARGUMENT

Taxpayer verily believes that this case was properly determined by the findings of the District Court, as affirmed by the Court of Appeals. The Courts below cannot be reversed without being reversed on findings of fact.

The expenditures in question were incurred in connection with the management and conservation of income producing properties and were not capital in nature. Although the case was tried in the District Court and Court of Appeals primarily on the Government's theory that the expenses were personal in nature and thus non-deductible, the claim that they approached a capital nature was considered by the courts below and rejected on examination of the facts. Neither were the expenditures personal in nature, personal fees involved in the divorce, custody of and support for children, the disposition of personal residences or matters thus incidental to the divorce were never considered deductible.

The fees which were claimed were paid to counsel for extended and complex negotiations which ultimately led to agreement and transfer by taxpayer of securities to his wife in exchange for life control of her publishing company stock; and which led to agreement and transfer of taxpayer's and his wife's interests in business property to a trust, with a long term lease provided for his publishing business.

These fees were not a part of the cost of acquiring property, or resisting liability, nor were they personal in nature, but were, within the meaning of the statute, related

to the management and conservation of income-producing property, and uniquely so under the facts of this case.

Since 1942 there has been provision in the Internal Revenue Code for deduction of some nonbusiness expenses. This was the Congress's solution to the problem of lack of such legislation as emphasized by the case of *Higgins v. Commissioner*, 312 U. S. 212. An examination of the statute and the decided cases makes clear that whether or not an expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable. This does not apply to expenses primarily involved in sports, hobbies, or recreation, but does apply when such expenses are ordinary and necessary, reasonable in amount, and bear some reasonable and proximate relation to the production or collection of income or to the management, conservation, or maintenance of property held for that purpose. This on a showing that in this case the attorneys fees taxpayer was required to pay, not those fees, the District Court properly held them deductible. In this case the United States has not questioned that the fees were ordinary and necessary expenses and reasonable in amount. The issue grows out of the activity to which the fees related.

I

The trier of fact has determined that attorneys fees here involved bore a reasonable and proximate relation to the management, conservation, or maintenance of property held for income.

In this case the District Court, sitting without a jury, heard all the facts and circumstances and determined that the attorneys fees were expended by taxpayer in the management, conservation, or maintenance of income producing property.

In Trust of *Bingham v. Commissioner*, 325 U. S. 365, the Tax Court had heard the facts and concluded that legal fees were expended for the management and conservation of income-producing property. The Second Circuit reversed, 145 F. (2d) 568. The Supreme Court granted *certiorari*, and, in reversing the Second Circuit and affirming the findings of the Tax Court

> "* * * Deductible expenses * * * must be reasonable in amount and must bear a reasonable and proximate relation to the management of property held for the production of income. * * * Ordinarily, questions of reasonableness and proximity are for the trier of fact, here the Tax Court. *Commissioner v. Heininger*, 320 U. S. 467; *McDonald v. Commissioner*, 323 U. S. 57, 64-65; *Commissioner v. Scottish American Investment Co.*, 323 U. S. 119. * * * The Tax Court could find as a matter of fact, as it did, that the expenses of contesting the income taxes were a proximate result of the holding of the property for income. And we cannot say, as a matter of law, that such expenses are any less deductible than expenses of suits to recover income."

II

A. Attorneys fees reasonably and proximately related to the management, conservation, or maintenance of property held for the production of income are not personal, living, or family expenses, but are nonbusiness expenses properly deductible under Code Section 212 (2).

In *Lykes v. United States*, 343 U. S. 118, the Court reviewed the whole question of nonbusiness deductions. It cited in particular the House Committee Report:

> "* * * Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable * * * The expenses, however, of carry-

(ing) on a transaction * * * primarily as a sport, hobby, or recreation, are not allowable as non-trade or non-business expenses. Expenses to be deductible * * * must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income or to the management, conservation, or maintenance of property held for that purpose * * *." H. R. Rep. 2333, 77th Congress, 2nd Session. To the same effect see S. Rep. No. 1631, 77th Congress, 2nd Session. * * *

In *Lykes*, the ordinary and necessary character of the legal expenses incurred was recognized. Deductibility turned wholly upon the nature of the activities to which they related. And so as taxpayer sees it, does this case.

Lykes considered a gift tax question. The taxpayer gave away stock with a fixed value and the Commissioner of Internal Revenue revalued it and assessed a deficiency. The fees in that case were incurred in contesting this deficiency or in resisting liability, not as in the instant case, in seeking and finding a legal and acceptable manner for rearranging holdings of income producing property and still conserving income and income producing property. In *Lykes* the Court was faced with the facts and also with Treasury Decision 5513, 23 CFR 29.23 (a)-15 (k) in force since 1946 (to which it gave weight) unequivocally holding that fees in determining gift tax liability are not deductible.

In *Bacon v. Commissioner*, 196 F. (2d) 646, the Eighth Circuit Court of Appeals held that "* * * the controversy did not go to the question of liability but to the manner in which it might be met by the petitioner without greatly disturbing his financial structure * * *." The Court allowed $16,500.00 of the husband's attorneys fees as being involved in the maintenance or conservation of property for the production of income.

Fees similarly were allowed on this basis in *Fisher v. United States*, 157 Fed. Supp. 304; and *Alley v. United States*, 56-2 USTC 9867.

In *Bowers v. Commissioner*, 243 F. (2d) 904 (6th Cir.) the Court allowed a $45,000.00 attorneys' fees as claimed, with the statement that as in the *Bacr* case there was little occasion for lawyer's services in the divorce, that their services were largely devoted to adjustment of the taxpayer's liability to his wife.

In *McMartin v. United States*, 132 Fed. Supp. 114, the Court of Claims cited *Bacr* and gave taxpayer an opportunity to show to what extent legal expenses were incurred in conservation and maintenance of property.

In certain cases attorneys fees have been denied. But they are easily distinguished from the instant case.

In *Harris v. United States*, 275 F. (2d) 238, the Ninth Circuit held that attorneys fees were incurred to resist the wife's claim that there was community property and there was no evidence of the value of the attorneys fees in dividing property. This case, the Court said, was not *Bacr*.

In *Tressler v. Commissioner*, 228 F. (2d) 356, the Ninth Circuit cited *Bacr* and *McMartin* but distinguished *Tressler* by saying that the expense of the litigation was incurred to defeat the wife's suit and not to protect the petitioner's property.

In *Howard v. Commissioner*, 202 F. (2d) 28, the Ninth Circuit cites *Bacr* with approval but says that Howard's fees involved the defense of the wife's action to collect money awarded her in a divorce action and therefore were not deductible. *Smith's Estate v. Commissioner*, 208 F. (2d) 349; and *Norton v. Commissioner*, 192 F. (2d) 960, can be similarly distinguished.

In refusing to permit deductions, the Fourth Circuit has said in *Richardson v. Commissioner*, 234 F. (2d) 248, that " * * * It is clear that the attorneys for the husband expended no effort in the conservation or maintenance of his property as envisioned by the statute. * * * Their services were directed to preventing any liability being imposed upon the husband for the wife's support and it is this for which they were paid. * * * Even if any part of the fee paid by him to his attorneys could be said to be for services in conserving his property, no effort has been made to show what part of the sums paid should be allotted to that purpose. * * * Unless and until it is shown what part of the sums paid them are applicable to that part of their efforts there is no basis upon which to grant a deduction. * * * None of the conditions which formed the basis for the decision in the *Baer* case exists in the case now before us."

In *Douglas v. Commissioner*, 33 T. C. 349, the wife was attempting to deduct legal fees incurred in an effort to secure property in connection with a marital separation. *Doniselli v. Commissioner*, 16 T. C. 1196, disallowed deduction of legal expenses paid in resisting a former wife's suit to collect back alimony. This case was decided before the *Baer* case.

In *Lewis v. Commissioner*, 253 F. (2d) 821, the Second Circuit refused to allow attorneys fees on the theory that such fees were spent in resisting legal separation proceedings and liability. But the case was in no way similar to the *Patrick* case.

Judge Waterman did write in *Lewis*, *supra*, that he could not reconcile *Baer* with *Lykes*; but Judge Lumbard would limit this discussion to distinguishing *Baer v. Commissioner* on its facts" and he would have allowed expenses in litigation over revocation of an *inter vivos* trust.

All decisions read with the statute and *Lykes* in mind simply bear out that not all attorneys fees are deductible but equally that in certain circumstances they are. A broad rule such as is sought by the Government here would bar relief in proper cases such as the instant one.

The Courts have allowed deduction of attorneys fees in property settlements growing out of divorces where there is a reasonable and proximate relation to production of income or conservation or management of income property.

B. An essential in this case, as in the Baer line of decisions and as outlined in the Lykes case, was that the fees were not expended to resist liability but to find a manner in which it could be met without depriving taxpayer of his income or income-producing property.

Consideration should be given to the question as to whether or not a "threat" to property is the real test in the *Baer* line of cases. It is true that a "threat" appears, but that was the occasion for the expenditures of fees, rather than the justification therefor under the law.

In any event, there was a unique "threat" to both the income and the income-producing property of taxpayer in this case. (R. 31.)

At the time he was sued for divorce, taxpayer was a minority stockholder in Herald Publishing Co. Because of the family unity which had existed, taxpayer had controlled the Herald operations and had been Editor and Publisher of the newspaper and a director and president of the corporation and drew salaries therefrom. With the commencement of the suit against him, his life work and the property which he had built up was a risk. There was the distinct possibility that control of the corporation would be sold, and the wife's attorneys were approached by prospective purchasers.

It was not necessary for his wife to take from him his Herald stock, for taxpayer to be subject to the loss of his salaried position and his only salary income as well as control of the operations to which he had given years of effort and which he had built up. His wife, with her 25% of the stock and as trustee jointly controlling the stock of her children and, with the support of her son Hugh would have controlled the corporation. With family unity broken, this control could have been exercised by the wife to taxpayer's detriment.

It developed in the negotiations that there was a way to meet the wife's claims and to retain control of the publishing business and conserve the property he had built. His wife had independent means and sought generally either to retain her stock control of the publishing business (R. 24) or to get up so that he could never sell the property. He was not engaged in resisting liabilities, and attorneys fees were not expended for that purpose. The negotiations concerned themselves with the manner in which taxpayer could meet all claims and conserve his income property. This was the immediate purpose of the expenditures of the fees. The United States argues that the agreement between the parties as to the manner of solution shows full accord and harmony between the parties and no risk to taxpayer. In so arguing, Petitioner is ignoring a fact of life: that months of patient negotiation by competent and experienced counsel concerned with the best interests of their clients was necessary to effect the agreement.

The risk and danger to income and specific income-producing property was there until the matter was concluded. And it was not concluded until there was a readjustment of income-producing holdings under which the taxpayer gave up his undivided interest in the building occupied by the newspaper and thus assured that there

would be no partition of this real estate or outside co-owner and no interruption of occupancy of the building, conserving also its income producing potential for the children of taxpayer and his wife. Prior to this agreement, the wife had equal rights to control or block control of the use of this business real estate. (R. 32, 33.)

The matter was not concluded until taxpayer had transferred some $112,000.00 in high quality income producing stocks and bonds in exchange for what amounted to a voting right for life in the wife's stock in the newspaper corporation. The manner of meeting taxpayer's liability in this particular was important in preserving his financial structure. It is implied that there was no overt move to claim taxpayer's stock and that anything else of value would have satisfied the wife's claim and that stocks and bonds did in fact satisfy this claim without disturbing taxpayer's Herald stock. But Mr. Spencer testified that he was convinced that Mrs. Patrick had a definite and special interest in the Herald Publishing Co. stock as such, for reasons shown, and would not in any sense have considered some other blue chip stocks of equal monetary value to be acceptable by way of direct exchange with no limitations. (R. 37.)

Examination then reflects that the essential element outlined in *Lykes* and considered in *Bacl* and related cases is present in that the controversy did not go to the question of liability but to the manner in which it might be met without disturbing taxpayer's financial structure.

III

Attorneys fees were not the capital costs of acquiring stock or disposing of real estate but were reasonably and proximately related to the current management and conservation of income-producing properties.

A. The Government cites *Helvering v. Winmill*, 305 U. S. 79, decided in 1938 in connection with the acquisition of stock by Patrick. In that case it was held that taxpayer was in the business of buying and selling securities and would not be permitted to deduct broker's purchase commissions as a business expense on the basis that they constituted a part of the acquisition cost of the securities. The Government also cites *Crowley v. Commissioner*, 89 F. 2nd 715 (C. A. 6) decided in 1937. There it was decided that attorneys fees expended in litigation over alleged mismanagement of a corporation were no part of the ordinary business expense of a trust.

Neither of these cases resembles *Patrick*.

Taxpayer's salary, as he testified (R. 25) was low because of his interest in the newspaper and the building of a good property. It was necessary to his continued income and protection of the value of his income producing stock that he continue his control. So, the shifting of other income producing property for that which would assure him a voting control of the corporation and continuance of his positions with the corporation was necessary. These were incidents of management and conservation of income producing property; and this was a part of the necessary expense to him. His income situation was changed by the settlement, so that the newspaper position and property became more important in his total financial situation. He transferred properties which made up the bulk of his other income for properties connected with his business.

None of these facts tend to characterize his expenditures as a part of the capital cost of acquisition of stock. Additionally this Court does not know how many proposals, counter-proposals and efforts were involved before the final solution of transfer of securities for Herald stock was accomplished.

B. In considering negotiation of a long-term lease which assured taxpayer that his publishing business would continue occupying the building in which he had transferred his interest, the Government cites *Deputy v. duPont*, 308 U. S. 488, decided in 1940. The taxpayer's claim for deduction of dividends and income tax paid on borrowed stock was disallowed as not being an ordinary business expense: There the court was concerned with an "extraordinary" situation "beyond the norm of general and accepted business practice" and "so extraordinary as to occur in the lives of ordinary business men not at all" and in the life of the respondent "but once."

(And there appears a dissent by Mr. Justice Frankfurter to the effect that "what the activities of a taxpayer are is for the trier of facts" as is now argued in *Patrick*.)

Petitioner argues at Page 11, Paragraph 2, of its Brief, that "to the extent that the fees were incurred to assure the corporation's right to occupy the premises (*i. e.*, on behalf of the lessee) they should have been paid by the corporation, and respondent's payment of them constituted a contribution of capital to the corporation. Petitioner knows, or should know, that the corporation did pay a part of the attorneys fees and that this was disallowed by the Internal Revenue Service as not being a proper corporate expense. (R. 5.)

Taxpayer's placing of his undivided interest in the business real estate in trust along with the undivided in-

terest therein of his wife was an incident of management and conservation of his income producing property through assurance of income for his wife and children and through protection against division and guarantee of an undisturbed lease for his newspaper. This, too, was the result of negotiations by counsel for which the claimed fees were paid.

IV

Legal fees which taxpayer was required to pay his wife's attorneys were deductible exactly as were those he paid his own attorneys.

Attorneys fees were demanded in the divorce action and required to be paid by taxpayer under the State Court's Final Order. So far as they related to the divorce and the essentials thereof ($2,000.00 to his own and $2,000.00 to his wife's attorneys) they were paid by taxpayer and not claimed as deductible.

But $19,200.00 in fees paid jointly to the attorneys for taxpayer and his wife and attributed to the long negotiations which resulted in rearrangement of the stock and business properties were paid and are claimed as deductible. It was a part of his agreement, necessary to attain agreement, that he pay these fees. And subsequently, the court, in approving the transfer and exchanges of properties, directed by its Order that he pay all attorneys fees.

In contesting this claim, the Government cites *United States v. Davis*, 370 U. S. 65 & 74-75. That recent case in no way resembles *Patrick*. There the fees were for specific tax advice of benefit only to the wife and for services to her. The attorney, it was found, "considered the problems from the standpoint of his client alone. Certainly then it cannot be said that . . . (this) advice was directed to plaintiff's tax problems. . . ."

The facts, as reviewed below, were different as to *Patrick*, and were, in the ordinary practice, unusual. And they were considered in full by the trier of the facts.

Owens v. Commissioner, 273 F. 2nd 251 also was unusual in much the same sense. There the Fifth Circuit permitted deduction of fees paid to the wife's attorney, who also represented the husband, in a property settlement incident to a divorce. The Court set out, as is argued here, that "• • • deductibility turns wholly upon the nature of the activities to which they related • • • We do not think that the fact that the payment was made to the wife's attorney has any determinant force • • • The ultimate and only fact before the Tax Court and before us was and is whether the $7,500.00 was actually paid to the attorney in connection with the saving of the business in which the husband was interested • • • In other words, the domestic dispute furnished the occasion, but not the motive, for the payment of the $7,500.00 to the attorney."

From the Patrick record it appears that much of the negotiations of attorneys in connection with the property settlement was designed to arrive at a means of permitting taxpayer to retain his control of the newspaper and his offices and employment but to "tie up" and limit his interest in a manner acceptable to his wife. And in this area it appears that there were "almost joint aims" of opposing counsel (although certainly within every bound of propriety).

John H. Lumpkin, counsel for the wife, testified that "I am trying to recollect as precisely as possible, which is the reason for my pause, the background and the reasons for the final stipulation. Certainly in part it was as stated by you, to tie up his interest thereby protecting the children. Certainly in part it was to continue him in active

management of the newspaper and to provide that if he should dispose or could dispose of his interest, the children would be protected, and finally, I think a very cogent reason in these negotiations as culminated in the Stipulation, was to continue him in an income producing status."

He was asked by counsel for the Government: "Mr. Lumpkin, are you speaking of the negotiation as a whole or the aims which you were striving for as Mrs. Patrick's attorney?" and he replied: "I might say those are almost joint aims as between Mr. Spencer as attorney for the Defendant and by me as Attorney for the Plaintiff." (R. 44.)

It is true the Eighth Circuit did not allow the wife's attorneys' fees in *Baer*. But in *Baer* it was argued that $35,000.00 for purchase of a home and $20,000.00 attorneys fees were "periodic payments" to the wife when all the evidence showed this as a lump sum part of a divorce settlement. There was no claim or finding of fact that the fees were related to the conservation of income producing property. The present (*Patrick*) case makes no attempt to deduct the elements of the settlement on taxpayer's wife nor does it claim that the attorneys fees were part of "periodic payments" to her. It poses the question as coming within the thinking of the *Lake* case: That the fees were reasonably and proximately related to the management, conservation and maintenance of income producing property.

In *Norton*, *Richardson*, and *Lewis*, all examined herein above, the wife's attorneys fees were not allowed. But the question here posed was not answered there since none of the fees was allowed. It would follow that if the attorneys fees, because of the activities to which they related, were not deductible as to the husband's attorneys, they would not be deductible by him as to the wife's attorneys.

The Government cites *Welch v. Helvering*, 290 U. S. 111, decided in 1933, which simply held that the voluntary payment of debts of a bankrupt firm in order to gain good will was not an ordinary expense of the operation of a business. And it cites *Majestic v. Sapplee*, 216 U. S. 394, which did not allow as deductible expenditures in payment of the personal liability (a tax lien) of a predecessor in title; and *Interstate Transit Lines v. Commissioner*, 319 U. S. 590 which disallowed payment of a deficit for a subsidiary business. These cases are too remote to affect the right of the taxpayer to avail himself of the "legislative grace" of a deduction for expenditures made by him in the circumstances of this case.

The only test under the Statute is that the fees be expended in a transaction reasonably and proximately related to the production or collection of income or the conservation, management, or maintenance of income-producing properties. If they were so expended, then they are deductible no matter to whom they were paid. And, on the facts, it was found in the courts below that they were so expended and were deductible.

CONCLUSION

The judgment of the Courts below should be affirmed.

Respectfully submitted,

ROBERT M. WARD,
Box 1074,
Rock Hill, South Carolina,
Counsel for
Talbert Patrick, et al.

Rock Hill, South Carolina,
November, 1962.

No. 22

In the Supreme Court of the United States

OCTOBER TERM, 1962

UNITED STATES, PETITIONER

v.

TALBOT PATRICK, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

REPLY FOR THE UNITED STATES ON REARGUMENT[1]

ARCHIBALD COX,
Solicitor General,
LOUIS F. OBERDORFER,
Assistant Attorney General,
[illegible],
Assistant to the Solicitor General,
[illegible],
Attorneys,
Department of Justice, Washington 25, D.C.

[1] They also respond to the original brief on the merits filed by the United States.

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BRIEF FOR THE UNITED STATES ON REARGUMENT[1]

OPINION BELOW

The opinion of the district court (R. 46-52) is reported at 186 F. Supp. 48. The opinion of the court of appeals (R. 59-67) is reported at 288 F. 2d 292.

JURISDICTION

The judgment of the court of appeals was entered on March 27, 1961. (R. 68.) On June 24, 1961, by order of the Chief Justice, the time for filing a petition for writ of certiorari was extended to and including July 25, 1961. The petition was filed on July

[1] This brief, and the separate brief being filed in *United States* v. *Gilmore*, No. 21, replace the joint brief filed in the two cases in the 1961 Term (Nos. 255 and 256).

25, 1961, and granted on October 9, 1961. (R. 69, 368 U.S. 817). The case (No. 256, 1961 Term) was argued on March 28, 1962, and by order of April 2, 1962, was restored to the calendar for reargument (369 U.S. 835). The jurisdiction of this Court rests on 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

1. Whether the following attorneys' fees incurred by a husband in effecting a property settlement agreement incident to a divorce qualify as "ordinary and necessary expenses paid or incurred * * * for the management, conservation, or maintenance of property held for the production of income" so as to be deductible under § 212(2) of the Internal Revenue Code of 1954, or are nondeductible "capital" or "personal" expenses:

(a) The fees for services in negotiating a purchase by the husband of his wife's stock in a corporation of which he was president, the object of the purchase being to give the husband a controlling interest in the corporation;

(b) The fees for services in negotiating a new long-term lease to the corporation of real property owned by the spouses;

(c) The fees for services in negotiating and executing a transfer of the leased property to a trust, to pay the income to the wife for life and then to convey the property in equal shares to the parties' three children;

(d) Such part of the fees thus paid as may be deemed to have served also the object of forestalling

an assertion by the wife of her rights to a substantial part of the taxpayer's property in satisfaction of his marital obligations to her.

2. Whether the taxpayer may deduct any part of the fees paid by him to his wife's attorneys for services performed in her behalf.

STATUTES AND REGULATIONS.

The pertinent statutes and regulations are set forth in the Appendix to our brief in the companion case, *United States v. Gilmore*, No. 21.

STATEMENT

1. In 1935, the respondent's wife filed suit for an absolute divorce on grounds of her husband's adultery. There were three children of the marriage, one of whom had attained majority (R. 4).

At the time of the divorce suit, the respondent was president of the Herald Publishing Company in Rock Hill, South Carolina, and editor of the newspaper published by it. (R. 3.) He owned 28% of the Company's stock, his wife owned 28%, and their adult son, Hugh, owned 9%. The remaining 35% was held in trusts for the three children which had been established by Mrs. Patrick's father. The real property which housed the newspaper was owned in common by Mr. and Mrs. Patrick, their interests being $\frac{4}{5}$ and $\frac{1}{5}$, respectively. (R. 4.) The couple

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Talbot Patrick will be referred to as the sole respondent. The administrator of the estate of his second wife, Alethia M. Patrick, is a party only because a joint return was filed in 1956. Paula M. Patrick, the former wife, will be referred to as taxpayer's "wife", notwithstanding the divorce.

also owned two houses. (R. 8.) In addition, each of the spouses independently owned diversified securities and other assets of substantial value.[3] (R. 16–17, 25–26, 37.)

Pending the divorce suit and prior to the filing of the respondent's answer (R. 30), the parties negotiated an agreement settling "all rights whatsoever * * * concerning the matter of support, separate maintenance, alimony or any financial obligation of whatsoever sort due to [the wife] * * * on account of and growing out of the marital relationship" (R. 13). Besides provisions for the custody and support of the minor children and a provision giving one of the two houses to each of the parties, the agreement was concerned solely with the disposition and readjustment of the parties' intertwined interests in the newspaper properties; none of the other income-producing properties of either spouse was dealt with (R. 7–15).

The nature of the negotiations leading to the agreement is fully disclosed by the depositions of the attorneys representing the two parties (Spencer, R. 29–41, 55–56; Lumpkin, R. 41–46, 56–57), and there is no conflict between them as to the character of the negotiations and the purposes of the attorneys in conducting them (see, *e.g.*, R. 44). On behalf of Mrs. Patrick, her attorney considered it desirable that Mr.

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[3] The court of appeals' statement that the newspaper properties were the "only" income-producing properties of the parties (R. 60) is in error. Not only did the respondent have $112,000 worth of blue-chip securities to exchange with his wife (see below, p. 5), but of his some $55,000 of gross income reported for 1956, no more than about $25,000 was traceable to the newspaper properties (see R. 25–26, 37, 38).

Patrick continue as editor of the newspaper. (R. 44–46.) His attorney, however, thought that notwithstanding the absence of any present disagreement, Mr. Patrick should assure himself against being outvoted in the future by the combined voting power of Mrs. Patrick and her son, Hugh, who seemed somewhat to side with her (R. 18, 55–56), and advised him to seek to acquire control of the publishing company by buying Mrs. Patrick's shares (R. 31–32, 34–36, 40). Mrs. Patrick recognized that she could not expect him to continue to manage the newspaper, in the light of their strained relations, subject to the threat of being outvoted, and she was quite willing to sell her shares to him for their fair value. (R. 38, 40, 43–46.) Her only concern, her attorney explained, was to make sure that the newspaper properties would ultimately go to the children (R. 43, 44–45), one of whom was already in the business and the other of whom was preparing to enter it (R. 37). Mr. Patrick's own attorney similarly understood that Mrs. Patrick, having adequate independent means, did not want anything for herself and was concerned only to protect the interests of the children (R. 37). Mr. Patrick, in turn, was entirely agreeable to assuring the ultimate devolution to the children, who were equally the objects of his bounty. (R. 25, 38–39.)

The outcome of the negotiations was an agreement that Mr. Patrick would give to Mrs. Patrick high-quality listed securities acceptable to her equal in value to the agreed value of her 28% of the publishing company stock ($112,000, R. 38), and that Mrs. Patrick would transfer her stock to him subject to the

condition that it should go in equal shares to the children in the event of his death or in the event of a sale of the entire business." (R. 11–12.) As to the real property housing the newspaper, a new long-term lease with the newspaper was negotiated and both parties then transferred their interests to a trust, with the income to be paid to the wife for life and the property then to go in equal shares to the three children. (R. 8–10.) Finally, Mr. Patrick agreed to pay all of his wife's attorneys' fees in connection with the divorce and the negotiation of the property agreement. (R. 12.)

After the agreement was concluded, the respondent filed an answer in the divorce suit neither admitting nor denying the alleged adultery (R. 30). Following a brief and uncontested trial establishing the grounds for divorce, a decree was entered granting Mrs. Patrick a divorce and incorporating and approving the settlement agreement that had been reached by the parties (R. 46–47).

2. During 1956, the respondent paid attorneys' fees for all services connected with the divorce and the agreement, totaling $24,000—$12,000 to his attorneys and $12,000 to his wife's attorneys. The total of $24,000 was allocated by agreement of counsel and

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[1] The condition attached only to the shares purchased from Mrs. Gilmore. It did not attach to the 28% already owned by Mr. Gilmore (see R. 11–12) and the court of appeals' statement to the contrary (R. 60–61) is in error.

[2] The court of appeals' opinion is in error in describing the trust as being solely for the children (R. 61), since it omits the wife's life estate.

the parties, without distinction between the wife's fees and the husband's, as follows: $4,000 for obtaining the divorce itself; $10,000 for negotiating the stock transfer; and $4,000 for negotiating the new lease of the real property and transferring the property to the trust. (R. 6, 32–33, 36, 47, 56.) Mr. Patrick claimed a deduction for the $10,000 item and for ⅔ ($3,200) of the $4,000 item, relating to the business real estate. (R. 6–7.) Both courts below held that the entire $19,200, without distinction between the fees paid to the husband's attorneys and those paid to the wife's attorneys, was deductible under Section 212(2) of the Internal Revenue Code of 1954[*] as an "ordinary and necessary expense paid or incurred * * * for the management, conservation, or maintenance of property held for the production of income." (R. 49–51, 67.)

ARGUMENT

Despite our filing of a joint brief in the two cases at the last Term, this case, upon analysis, is quite different in its main aspects from its companion, *United States* v. *Gilmore*, No. 21. The difference is that most of the items in dispute in this case do not, in our view, involve an assertion either of marital

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[*] All references in this brief are to the 1954 Code. The following table correlates the relevant 1939 Code sections, discussed in our *Gilmore* brief, with those of the 1954 Code:

1939 Code	*1954 Code*
§ 23(a)(1)	§ 162
§ 23(a)(2)	§ 212 (1) and (2)
§ 24(a)(1)	§ 262
§ 113(b)(1)(A)	§ 1016(a)(1)

rights or of adverse property claims. At least if the content of the negotiations and the resulting agreement be the guide, what this case primarily involves is simply a purchase and sale of stock between two parties who happen to be husband and wife and a long-term lease of real estate to a corporation by the persons who own it, who again happen to be husband and wife. Consequently, as we will show in Point I, the reason why most of the expenses of negotiating and executing the agreement were not deductible is not that they were "personal" expenses (though some of them were), but that they were "capital" expenditures. In Point II we will show that, if the wife's marital rights, though not overtly asserted, be nevertheless taken into account as a "latent" threat indirectly forestalled by the attorneys' services, it would go only to establish that a greater part of the costs should be treated as "personal" expenses for which not even an addition to basis should be allowed. In Point III, we note that the respondent is in no event entitled to a deduction for the fees paid his wife's attorneys.

I

THE COSTS OF NEGOTIATING MOST OF THE ELEMENTS OF THE AGREEMENT WERE CAPITAL IN NATURE, THOSE OF THE REMAINING ELEMENTS WERE PERSONAL

As we understand the allocation of the fees made, no deduction was claimed for the services of the attorneys in negotiating the amount the respondent was to pay for the support of the two minor children, the disposition of the two homes, and like matters. The deductions claimed and allowed were limited

rather to the fees for the attorneys' services (1) in negotiating the respondent's acquisition of his wife's 28% share of the stock of the publishing company, (2) in negotiating a new long-term lease of the real property to the corporation, and (3) in creating the trust and transferring the real property (subject to the lease) to it. Limiting our discussion to those items, we will show that the first two items were primarily "capital" expenditures and that the last item was a "personal" expense.

1. *Negotiation of the stock purchase.*—In order to acquire a controlling stock interest in the corporation and thereby assure himself against being ousted should dissension with his ex-wife ever arise, the respondent gave his wife diversified securities of an equal value ($112,000) in exchange for her 28% of the stock. The costs of negotiating that stock acquisition, like the expenses of effecting the purchase of any capital asset, were nondeductible capital expenditures. It is no doubt true that the respondent, until he acquired a controlling stock interest, would stand in jeopardy of being ousted from his position as president of the corporation should he lose favor with those who controlled a majority of the stock. That, however, is true of every corporate officer who owns less than a controlling interest in the corporation by which he is employed; the officer whose tenure does not depend upon the favor of others is, we should suppose, the exception rather than the rule. Until this case, however, it has never been suggested that that circum-

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Regs. (1958 Code), § 1.263(a)-2; *Helvering* v. *Winmill*, 305 U.S. 79; *Lyeth* v. *Commissioner*, 86 F. 2d 71 (C.A. 6),

stance converts the expense of buying up a company to assure one's tenure in its employ into an ordinary and necessary expense of carrying on the "trade or business" of being an employee of the corporation.[5] Voting power is a basic attribute of corporate stock, and the power its ownership gives to control (among other things) the corporation's personnel decisions is but one of the things that gives stock its value as a capital asset.[6]

The respondent did not acquire unfettered ownership of his wife's stock but took it subject to the condition that it pass to the three children upon his death or a sale of the corporation. If that affects the conclusion, it does so by suggesting that part of the expenses of the stock transfer should be treated as "personal" expenses not allowable even as a basis addition. The transfer of the "remainder" to the children can be seen as a gift from the respondent to his children or as a transaction approaching, as the coercion from his wife to make the "gift" increases, a transfer of values from the respondent to his wife in recognition of her marital rights (by his paying full value for the stock but receiving less than a life estate) and a gift by her to the children. In either

[5] The respondent's job was a "trade or business" and thus the relevant provision of the Code on the court of appeals' theory of the case (a cost of keeping the job) is § 162, not, as the court assumed, § 212(2).

[6] Whether the power marriage gives of "control" one's wife's votes is of equal reliability we need not debate. However efficacious it might be, marital "control" is not a capital asset, and its replacement with stock ownership is something more than a mere preservation of an existing status, the court of appeals to the contrary notwithstanding (R. 61, 65).

view, that aspect of the transaction is purely "personal" and any part of the fees allocable to it would be both nondeductible and noncapitalizable.

2. *Negotiation of the long-term lease.*—In negotiating a long-term lease of the building to the corporation, the respondent wore two hats, acting both for the corporation as lessee and for himself as lessor. To the extent that the fees were incurred to assure the corporation's future right to occupy the premises (*i.e.*, on behalf of the lessee), they should have been paid by the corporation,[9] and the respondent's payment of them constituted a contribution of capital to the corporation. To the extent that the fees were for services on behalf of the lessors, they were required to be capitalized as the cost of obtaining a long-term lease, recoverable through amortization deductions over the term of the lease.[10] Either way, the fees were, as to the respondent, nondeductible capital expenditures.

3. *Creation of the trust.*—Under the agreement, the respondent and his wife joined in conveying the building (subject to the new lease) to a trust, the income to be paid to the wife for life and the property then

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[9] *Deputy v. duPont*, 308 U.S. 488. Even if the corporation had paid the fees itself, it would have been required to capitalize them as the cost of obtaining the leasehold and amortize them over its term. Regs. (1954 Code), § 1.162-11(a); see § 178(a)(2) of the Code.

[10] *E.g., Helvering v. Manhattan Life Ins. Co.*, 71 F. 2d 292 (C.A. 2); *Young v. Commissioner*, 59 F. 2d 291 (C.A. 9); *Commissioner v. Chicago Dock & Canal Co.*, 84 F. 2d 288 (C.A. 7); cf. Regs. (1954 Code), § 1.167(a)-3. If the transfer of the leasehold property to the trust be treated as a gift, with the trust taking the grantor's basis, the trust would acquire the right to the amortization deductions. See §§ 1015, 167(f).

to go in equal shares to the three children. However viewed, the costs both of negotiating and of effectuating that agreement were, in their entirety, nondeductible "personal" expenses. To the extent that the wife gained something for herself by the transaction—*i.e.*, if her acquired life interest in the whole was of greater value than her relinquished fee interest in one-fifth—there was a transfer to her in recognition of her marital rights. The transfer of the remainder to the children was of the same character as in the stock transfer considered above and, as there shown, was either a gift from the respondent to the children or a transfer in recognition of his wife's marital rights, in either of which events it remains a purely personal transaction.

II

TO THE EXTENT THAT THE COSTS OF ARRIVING AT THE SETTLEMENT ARE TREATED AS A COST OF FORESTALLING AN ASSERTION OF LATENT MARITAL RIGHTS, THEY WERE PERSONAL AND MAY NOT BE TAKEN INTO ACCOUNT EVEN AS AN ADDITION TO BASIS

In Point I, we based the characterization of the attorneys' fees on the nature of the matters to which their services were immediately directed and showed that on that approach the costs were primarily "capital" expenditures (which, though not currently deductible, could nevertheless be accounted for by a basis adjustment). The courts below, however, emphasize the existence of substantial, if latent, marital rights and the indirect consequence of the attorneys' services in forestalling, by arriving at a satisfactory agreement on the other matters, an overt assertion of those

rights. The reasoning is this: the respondent's wife was entitled to an absolute divorce because of his undenied adultery;[11] a divorce on that ground would entitle her to "a substantial property settlement"; "all" of the respondent's property was thus "at risk until settlement was made" (R. 49); the negotiation of an agreement satisfactory to the wife, therefore, even though nominally one for the purchase by the respondent of *her* property, served ultimately to protect *his* property from an assertion of the wife's latent rights; and hence the attorneys' fees were a cost of protecting the respondent's income-producing property from his wife's potential claims for a marital settlement.

We are entirely willing to accept that view of the matter, for as shown at length in our *Gilmore* brief, the costs of resisting (or, here, forestalling) an assertion of inchoate rights arising from the marriage relationship are plainly "personal" expenses, a deduction for which is expressly disallowed by § 262 of the Code. The effect of so viewing the case would not be to improve the current deductibility of the costs, but rather to preclude the right to account for them even by an addition to basis. We have characterized the fees as being primarily a cost of purchasing the wife's stock and of leasing the building, rather than a cost of resisting an assertion of marital rights, only because that seems to us the proper analysis, not because we have anything to gain by opposing the latter characterization.

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[11] For the record, we might note that respondent's answer, failing to deny the charge, was not filed until *after* the property agreement was reached (R. 30).

III

RESPONDENT IS NOT IN ANY EVENT ENTITLED TO A DEDUCTION FOR THE FEES PAID HIS WIFE'S ATTORNEYS

The respondent is not in any event entitled to deduct the fees paid to his wife's attorneys for services performed in her behalf.[7] *See United States* v. *Davis*, 370 U.S. 65, 74-75, argued as a companion to this case in the arguments last term; *Lewis* v. *Commissioner*, 253 F. 2d 821, 828 (C.A. 2). The services were in behalf of the wife, not of the respondent, and a taxpayer cannot deduct as his own the expenses of another (*Welch* v. *Helvering*, 290 U.S. 111; *Deputy* v. *duPont*, 308 U.S. 488) even though he be obligated to pay them (*Magruder* v. *Supplee*, 316 U.S. 394; *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590).

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
WAYNE G. BARNETT,
Assistant to the Solicitor General.
HAROLD C. WILKENFELD,
Attorney.

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[7] In *Owens* v. *Commissioner*, 273 F. 2d 251 (C.A. 5), relied on by the court below, the attorney was found to be working for the husband.